BANKS

AND

THE MONEY MARKET

BY

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Dedicated

TO

DR. PRAMATHANATH BANERJEA,

M.A., D.SC., BAR-AT-LAW.

Minto Professor of Economics, and President,
Post-Graduate Council in Arts,
Calcutta University,

PROFESSOR PRAMATHANATH BANERJEA,

M.A., B.L., BAR-AT-LAW

AND

MR. RAMAPRASAD MUKERJEE, M.A., B.L.,
Ex-Member, Council of State

Who have in many ways encouraged the research activities of the author.

BANKS AND THE MONEY MARKET.

LECTURES DELIVERED BEFORE THE INSTITUTE OF BANKERS (CALCUTTA CENTRE).

(WINTER SESSION, 1930-1931).

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PREFACE.

In response to numerous requests I have decided to reprint this monograph which consists of my lectures delivered to the Institute of Bankers during the winter session of 1930-1931. To deal with such a vitally important subject in the course of four lectures proved indeed a difficult task and attention was, therefore, drawn to the salient aspects of the subject. A comprehensive treatment of the subject would involve references to the whole theory of banking and currency. Policies tried abroad in the perfection of their money markets would have to be alluded to. It would have been beyond the possibilities of the course of four lectures to begin with those different organisations which are the constituent members of the money market and close with a discussion of the best remedies suggested to evolve a co-ordinated, compact and cohesive money market. Lectures one, two and three which cover a greater portion of the monograph are devoted to a lucid description of the ideal money market and the features of our money markets. This part of the work is elementary and matters of everyday knowledge in the City are dealt with in detailed manner for although they may appear simple to the trained practical banker are often misunderstood by untrained minds. Suggestions and new views are given in the final chapter which will repay study by the most experienced bankers, economists and businessmen.

Suggestions of interest to the businessmen will be referred to and the means for the development of the money market to a reasonable state of perfection will be studied. If I succeed in converting the lay reader to the principles of reform I would consider my humble efforts rather successful. The recent publication of the report of C. B. Enquiry Committee stimulated me in publishing this monograph for their recommendations have amply endorsed my suggestions concerning the necessity to create a bill market and a central reserve bank. No problem of domestic banking is so important as the one of making the Indian Joint-Stock banks take a greater part in the financing of our growing foreign trade. I hope the Indian publicist and the lay reader will find this monograph a useful guide. My thanks are due to the editors of the *Indian Finance, the Calcutta Review, the Journal of the Indian Institute of Bankers and the Indian Journal of Economics* for permitting me to reprint my papers originally published by them. The book is a companion volume of my previously published writings on banking, *viz.*, Elementary Banking, Present-Day Banking in India and Organised Banking in the Days of John Company.

B. RAMACHANDRA RAU.

26th October 1931.

SENATE HOUSE,

CALCUTTA UNIVERSITY.

Books by the same Author, published by the Calcutta University. Some Select Opinions thereon.

1. Present-Day Banking in India, by Dr. B. Ramachandra Rau, M.A., L.T., Ph.D. (*Third Edition, thoroughly revised and enlarged*). Supplementary Thesis for the Degree of Doctor of Philosophy, Calcutta University. Royal 8vo. pp. 704. 1930. Rs. 10-0.

The book describes the existing banking system and offers valuable suggestions to bring about the much needed improvement in our credit situation. The present edition, besides embodying the main conclusion of the earlier edition, incorporates a large amount of fresh material.

" A complete survey of the position—further useful chapters have been included on the recent monetary reform and the Central Bank of Issue. He examines the position of each of the constituents of the Indian Banking world and he suggests scientific remedies. His work will be much appreciated by his readers among the English banking community who will be specially interested in the author's suggestions as to the course which should be taken in the future. "—*The London Banker's Magazine,* Nov. 1930, p. 773.

" A third edition of this excellent treatise on Indian banking has now been published. The matter has been brought up to date and deals adequately with the Hilton-Young Report and the monetary reform of 1928."—*The Statist* (London), 24th January, 1931, p. 137.

" No topic on Indian Banking, present and past, has escaped the notice of the author. The chapters on the indigenous banker, the loan companies of Bengal and topics of the Hundi system, agricultural credit and banking management evince a painstaking spirit of research and original remarks. The author has boldly criticised and impartially pronounced judgments on many of the partisan-like conclusions which are unfortunately prevalent in circle of the experts, real or so-called, in banking. "—*The Calcutta Review,* February, 1931.

" It is a self-contained, complete and comprehensive exposition of the Indian financial world with all its peculiarities. I can think of no class connected with the business-world to whom the book is not welcome or necessary. "—*Indian Finance*, Nov. 22, 1930.

" A very comprehensive text-book. "—*The Economist*, London, Oct. 11, 1930.

" A full description and criticism of the banking system. "—*The Manchester Guardian, Commercial*, Oct. 9, 1930.

" It is probable that it will become a standard work in the sense that it will be studied by those not inconsiderable few who aspire to a knowledge of the credit system at present existing in India. An extremely able exposition of present-day banking in India. "—*The Capital*, Oct. 29, 1930.

" It is a masterly exposition of the subject by a person who can speak with authority and confidence. "—*The Leader*, Nov. 2, 1930.

" A. very masterly survey of the whole field of banking."—Principal M. K. Ghosh.

" It is a valuable contribution to the literature of Indian Economics. Prof. Rau has rendered a signal service to India by publishing his book at this juncture when the Banking Enquiry Committee is conducting its investigations. The presentation is admirably lucid and systematic and his book will be read with interest by bankers, businessmen and the general public. "—*The Statesman*, Nov. 30, 1930.

" The book contains collection of important banking material which will be useful to students and businessmen alike. Its possession would give much useful information and save reference to a number of publications. "—*The Indian Journal of Economics*, April, 1931, p. 714.

" An interesting chapter for the American reader is Chap. 14 which describes the hoarding habits of the native population."—*The American Economic Review*, March, 1931, p. 169.

" Remarkably good book on Indian banking. The author has a clear grasp of the main principles and his patient and diligent study has given him mastery of the subject which he expounds even to the uninitiated in simple and clear language."—*Sir* B. N. Sarma, *Ex*-Executive Council Member, Government of India and President of the Railway Rates Advisory Committee.

"It will serve both as a useful work of reference and a dependable text-book. Dr. Rau has gone thoroughly into his subject, almost too thoroughly at places and piles up an imposing amount of information and observations collected from wide reading and long experience in teaching. His book is quite as much a book on Indian banking as on banking and currency in general. Dr. Rau's special contribution is an examination with suggestions of his own of the question of a Central Bank of Issue for India. His treatment is sound and his sweep wide considering the fact that *he wrote before the publication* of the Banking Committee's exhaustive and weighty report."—*The Ceylon Economic Journal*, December 1931.

"In his very extended examination of the conditions Mr. Rau gives a most interesting statement of the methods of indigenous bankers, past and present and traces the development of the European System such as it has been from the days of John Company. Written by one who has a thorough knowledge of conditions in India and of financial matters in general, the book may be commended to the student of monetary questions and it may be added that the whole body of Mr. Rau's suggestions are worthy of the considerations of controlling financial interests and of the legislation. The plea that the Indian system should be brought into line with European models and as speedily as possible appears to be thoroughly sound."—*The British Trade Review*, November 1930, p. 39.

"Mr. Rau writes with authority and sound knowledge. Besides being a descriptive and historical account of the Indian banking system the book under review offers constructive suggestions for the immediate and practical problems. The reader will not fail to secure a comprehensive and clear-cut impression of the present-day banking system of India. A handy complete and reliable guide on this subject."—*The Bengal Co-operative Journal*, October 1925, p. 139.

"Researches made by Indian Economists in recent years have thrown considerable light on the gradual development of banking in India from earliest times and much valuable information on the subject will be found in the books published within the last five years by......... Ramachandra Rau............"—*The Central Banking Enquiry Committee Report*, 1931, p. 11.

2. **Elementary Banking,** by the same author Demy 8vo pp.209. 1925. Rs. 3.

This little book gives a clear idea of a Commercial Bank and its theory and estimates the economic importance of their

operations, *viz.*, Bank deposits, Note-issue, Drafts, Discounts, Loans and Advances, Investments and Acceptances. It will be a very useful book for commercial students who desire to understand the work of a bank— how it obtains its capital, how that capital is employed, how profits arise and are distributed and how again a Commercial Bank fails.

"It is clear and concise."—*The American Economic Review.*

"A valuable handbook on Indian Banking."—*The United Provinces Co-operative Journal.*

"………We have all the essentials of a good text-book."—The reference to the text-books are sufficient evidence of the up-to-date character of the book—A substantial contribution to the rather lean literature on the subject."—*The Englishman*, 5th August, 1926.

3. **Economics of Leather Industry,** by the same author. Demy 8vo pp. 194. 1926. Rs. 2-8.

In this book the author makes a careful economic survey of the existing sources of supply and deals with the economic importance of leather, causes of the decline of the indigenous leather industry, the export trade of raw hides and skins and the possibilities of successful leather industry in this country. The book contains valuable suggestions for the improvement of the raw material on which the economic life of various branches of leather industry depends.

"…………..The series of the articles ought to be read generally by all interested in the industries and commerce of India and particularly by those who are concerned with the leather industry and business."—*Modern Review*, April, May, June, 1925.

"……The author is to be congratulated upon producing a clear and complete exposition of the Indian trade and of India's raw materials, resources and the characteristics of them………the information it furnishes will be interesting and valuable to the leather trade universally and the work forms an important addition to the trade's technical literature."—*The Leather Trades Review*, 10th February, 1926.

"The very able and practical monograph—His summary of suggestions deserves to be translated into the leading vernaculars of the country."—*The Mysore Economic Journal.*

"A useful glossary of terms—The book should prove useful to those interested in the economic side of the leather industries in India."—*The Bulletin of the Imperial Institute.*

"The Book is altogether interesting and suggestive and would repay reading."—*The Indian Journal of Economics.*

"Prof. Rau's volume is a great deal more than a mere academic treatise. He keeps himself in close contact with the market place and is therefore able to offer a number of suggestions which will certainly serve to stimulate the interest of those connected with the trade in the hitherto unexplored possibilities of the leather industry in India. The appendices undoubtedly enhance the intent of the book. We commend this book to businessmen and students alike."—*The United Provinces Co-operative Journal*, July 1926.

Book by the same author published by Messrs. Lal Chand & Sons, 76, Lower Circular Road, Calcutta and select opinions thereon.

1. **Organised Banking in the Days of John Company.** Rs. 12.

SOME OPINIONS ON ORGANISED BANKING IN THE DAYS OF JOHN COMPANY.

The Times of India—

"......................deals in detail with the history of banks in Bombay. Much information concerning the earlier Joint-Stock Banks and the indigenous banks of Bombay is contained in this book."

A. B. Patrika—

" Dr. Rau has already established his reputation as writer on a subject which though of great interest and use to us in our present requirements few Indians have tackled. It has been written in a style free from the liberal use of technical terms and yet in a spirit of scientific inquiry which is likely to be of interest to those who want to study banking and of use on the other hand as a book of reference to those who have a mind to follow up the researches embodied in the book.................. The picture is materially useful and instructive."

Dr. B. B. DAS GUPTA, *Ceylon University College, Colombo*—

" You have dug out much interesting information and deserve to be congratulated for your painstaking work in the early history of banking in Bombay."

MANU SUBEDAR, *Author of the Minority Report, Indian Central Banking Enquiry Committee and Vice-President, Indian Merchants Chamber, Bombay*—

" A very valuable contribution to the understanding of the economic revolution which India suffered since the past in the hands of the East India Company.

The book is of great historical value and I am sure you have rendered great service to the community by your researches in this direction."

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1.	Elementary Banking	3	0	0
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3.	Present-Day Banking in India (*3rd Edition*)	10	0	0
4.	Organised Banking in the Days of John Company	12	8	0

To be ready shortly :—

1. Some Foreign Banking Systems and their Lessons to India.
2. Economic Progress of India.

BANKS AND THE MONEY MARKET.

LECTURE ONE.

(16-12-30)

BRIEF DEFINITION.

Briefly defined, the money market* is the place where the idle or surplus funds or the floating cash of the important financial institutions of the nation seek temporary employment in buying such short-dated securities as bills, treasury obligations and other safe and liquid short-term obligations such as commercial paper or are lent to the stock brokers on an average for a long period of seven days as money at short notice or on day-to-day basis as call money. Bank bills, treasury obligations, trade bills and stock-exchange loans constitute the chief means by which these short-term loanable resources find an outlet. The money market constitutes the groundwork of the country's national finance whose main flexibility depends on fine division of labour and capacity for adjustment to changing financial conditions of society.

* It must be understood that the concept of a single money market with a common pool of funds means after all a composite system of over-lapping local markets responsive, however, to general influences.

The Main Characteristics of the Short-term Loan Fund.

"Eating the cake and having it too" is evidently a very lucrative and desirable business and the banker performs this self-same task in the employment of his funds as "call or short money." Coupled with the advantage of earning a definite rate of interest, the call money furnishes the banker the opportunity to replenish his reserve at any time when it is needed to meet unforeseen requirements or when any occasion arises for expanding his banking transactions. Call money has therefore been aptly designated as the "secondary reserve of banks" and financial institutions.

The Position of the Money Market in the Banking System.

If the whole banking system of a country can be likened to a smoothly revolving wheel, the most important cog of this wheel is the money market. The short-term loan fund at the disposal of the money market might form a meagre portion of the total bankable resources of the country, but the money market is the place where liquid money can be produced at the moment when it is needed. Ready cash for the immediate needs can be obtained easily at a few hours' notice. As one distinguished authority says "What a bank balance is to the individual the money market is to the country's credit system."

SEASONAL CHANGES.

Besides the liquidity of its funds, the other distinctive feature is the susceptibility of its funds to constant changes as a result of the constant changes in the demand for funds. Business and trade demand would tend to draw funds away from the money market and when the monsoon imposes dullness on human activity the funds flow back to the money market. Internal as well as international financial changes* tend to produce their effect on the loanable funds at the disposal of the money market. These forces tend to bring about a continuous activity of funds. Some economists who possess a mathematical frame of mind attempt to measure it in a precise manner. The turnover of bank deposits during the course of a year in an international market would tend to be greater than in the case of restricted domestic money markets. The perfect smoothness, quietness and resiliency with which the turnover takes place speaks for the thorough organisation of the money market as a whole. It is not the mere smooth adjustment of the marginal supply of funds to the marginal demand that ought to be the ideal of the regulators of the money market. Even heavy unexpected and extra demands for money ought to be supplied by the money market.

* For example, a mere wrong reading of the London Stock Exchange indicator as regards a supposed change in the bank rate caused consternation in the London Stock Exchange, which had its repurcussions in far off Calcutta even.—July 17th, 1931.

Any failure in this direction means abnormal tightness of money. The lack of elasticity of funds in the money market would lead to the occurrence of this phenomenon which ought not to be mistaken for money panic, which means that money has become "frozen" and at such times even the best short-term securities cannot be easily sold in the money market.

"The Finance Book" of the Bank.

The bulk of the loanable short-term money is generally in the hands of the major Joint-Stock Banks of the country. These big Joint-Stock Banks usually keep a finance book in which are entered the balances at the hands of the Central Reserve Bank and other correspondent banks. Probable receipts during the course of the day are estimated and probable payments are calculated and set off against the above items. Of the available funds, a balance is usually kept with the Central Reserve Bank and if anything extra is expected it would be generally set aside for use in the money market. Instead of this "notional surplus," a deficiency might be anticipated and the Bank attempts to cover this by withdrawing the "demand loans" from the money market.

Regulatory Authority.

Any individual and isolated action on the part of the Banks and financial institutions which supply

the bulk of the funds would often result in financial stringency, which unfortunately might be aggravated by timorous action on the part of the public into a financial panic. Too optimistic an attitude on their part would result in financial easiness or cheapness of money which prompts the businessmen to make an unsafe and perilous use of the bank's resources lent to them. A regulatory authority, such as a Central Reserve Bank, would shoulder the responsibility of equating the supply of credit to the needed demand. Acting as the custodian of the pooled reserves of the nation and expanding the note and deposit liabilities it tends to provide the whole of the extra demand at reasonably steady money rates. The comparative stability of the money rates all throughout the different seasons indicates the intelligent control of the loanable funds by the banking system of the country under the organic influence and careful suggestion of the Central Reserve Bank.

Day-to-day Fluctuations.

The day-to-day fluctuations of the call-loan rate of the Central Reserve Bank indicate plainly the frequency or otherwise of the individual borrowings or those of the other constituent members of the money market from the Central Reserve Bank. If local money markets exercise a pull on the resources of the banks stationed in the national money markets these transmit the pressure to the Central Reserve Bank. The rapidity with which these demands are

satisfied speaks for the elasticity of credit supply brought about by the C. R. Bank which maintains its constant contact with the money market through the borrowing banks. The financial stability of the nation depends on the prompt adjustment of the Central Reserve Bank credit to satisfy the commercial and treasury requirements which produce their first effect on individual bank reserves and the money market. Though this ought to be the tendency in the ideal or advanced money markets of the world we do not witness such a nice adjustment and balancing of the forces of demand and supply in the short-term loan markets of this country. Inter-bank call money rates indicate to a great extent the easiness or tightness of money in the short-term money market. But there are many " distortions " and unexplainable tendencies in the somewhat chaotic organisation of the money markets of this country.

The Constituent Members of the Money Market.

Viewed from the standpoint of the businessman, the term "money market" refers to the vast array of specialising institutions, such as the banks, Stock Exchanges, bill-brokers, acceptance houses, trust and finance companies and other specialising credit agencies whose main task is to supply the needed stock of money, be it State or Commodity Money, or substitutes for the legal tender State money known as representative money or Bank money. They

bring about at the same time an economical and safe transfer of the same to needy borrowers, *i.e.*, make loans to industry, trade and the Government for meeting their demand for working capital or loan capital of a more permanent character. Thus the constituent members of the organised money markets are the specialising credit agencies, the Treasury, the Stock Exchange and the Central Reserve Bank.

The Dual rôle of Modern Banks.

Although the above-mentioned functions are separate, yet in practice there is very little logical separation, for modern banks perform both the tasks, *i.e.*, of the accumulating of the monetary pool or stock and of transferring the same from the lethargic depositor to the go-ahead and economically ambitious borrower. Banks are "the largest professional lenders on short-term" and the main problem of banking is a satisfactory discharge of these dual duties. Standard money, currency and purchasing power are sufficiently well-known terms to the businessman and it is the duty of the modern banks to create efficient bank money. The proper organisation of the various types of money for a proper discharge of its different functions and the facilitation of the investment of the savings of the community as new capital at the *natural rate of interest* are the primary duties of the banking system of the country. It is the bounden duty of

the controller of the banking system to prevent the "commercial uses" of credit from being abused or turned into "financial uses." The creation of sound and elastic credit conditions can always be obtained when the banks adhere to the following golden rules which ought to guide their action. Firstly, it is their duty to realise the true volume of current savings, and by regulating the value and cost of new investment make it move step by step or hand in hand with the savings of the community. Secondly, the market rate of interest charged by the bankers has to be adjusted to the "natural rate" of interest. It is the duty of the banking system to secure the equilibrium between savings and investment. Without it there would be no stability of the price-level. The second condition is equally difficult to be realised in actual practice. It is indeed true that neither of these conditions can be actually secured in the daily routine of business operations of even the most highly developed banking systems. Although the banking system might be thoroughly organised it cannot control the rate of investment for both the volume and value of current investment lie absolutely outside the banker's scope and his suggestions are not generally heeded. Similarly, the banking system, unless it is intelligently guided, refrains from lowering the rate of interest during the days of slump and does not raise it during the days of boom. Thus it intensifies the amplitude of the industrial fluctuations or the "violence of the credit cycle" as economists would put it. The inherent

instability of credit is therefore a well-known phenomenon but it is the duty of the controller of the banking system to array *all* the forces at its command and by a *well-directed* use of those means at the *right* time and in the *right* degree mitigate the hardships arising out of the fluctuations. Skilled monetary management on the part of the Central Bank in properly adjusting the market rate of interest is the only way of securing sound credit conditions and this is the most signal service that the Central Reserve Bank can confer on the economic system of the country. If the chief Joint-Stock Bankers co-operate with the Central Reserve Bank and do not allow matters to pursue their own course, the effects of disequilibria can be toned down and the economic conditions of society rescued from dire evils which will adversely affect the national wealth.

The Bill-broker.

The bill-broker can be defined as the specialised dealer or middleman who provides a valuable link between the general trading public and the banks. The bill-broker and discount houses consider it their special duty to guarantee commercial credits. This is a respectable and creditable duty which can give scope to great activity on the part of these specialising agents. The existence of an open discount market and a rediscounting agency as that of a Central Reserve Bank enable these specialists to confine themselves to bill-broking as their sole occupation.

Acceptance Houses.

It is the main concern of the Acceptanoc Houses to open credits, accept bills and prepare them for the money market. A development of these facilities would provide the needed guaranteed bills which can be absorbed in the open discount market or by the Central Banking organisation of the country. Besides facilitating the negotiation of bills, the financing of trade between two centres is also taken up by them. They help the foreign governments in floating loans in the monetary centre and act as their agents.

The Trust and Finance Companies and the Issue Houses facilitate the investment of savings and afford a useful introduction of a number of people to the practice of investing their savings in industrial and commercial securities.

The Stock Exchange is the recognised market for investment. It refers to the general stock market and the provision of a Stock Exchange leads to the encouragement of the investment habit in general.

The Government of the country can exercise a dominant influence on the money market by virtue of the special features of its finance policy. The principal methods of Government borrowing for short-term periods would have their effect on the money market.

The Central Bank is the ultimate provider of cash for the money market when the supply of

floating cash in the hands of the Joint-Stock Banks and other credit supplying agencies is far smaller than the demand for the same which may be exercised by the Government, the banks, the bill-brokers and the Stock Exchange dealers. Just as it is its duty to provide the deficiency, its duty is to absorb the excess when such a contingency arises. Hence the performance of this providential function has earned for it the well-known term "shock-absorber". The unceasing vigilance with which it performs its functions enables the country to escape severe distress resulting from financial crises, except when these appear as concomitant features of industrial booms or depressions.

I have ventured to indicate briefly and place before you a coherent account of the salient functions of the different specialising credit agencies which ought to form the constituent members of the country's monetary organisation as a whole. Specialisation, co-ordination on the part of the specialists and intelligent regulation of the same by a supervisory body form the dominant features of the thoroughly organised money markets. Unhealthy rivalries and cut-throat competition are eschewed altogether by the controlling, dominating and stabilising influence of the Central Reserve Bank. At the top of the money market organisation and regulating the money market which would otherwise degenerate into a "tangled jungle of disorderly transactions" stands the Central Reserve Bank correlating their

activities and expanding and contracting credit according to the needs of trade. If instruments of credit, such as bills of exchange, are accepted as suitable cover for the expansion of currency, the currency and credit needs of the country would be satisfactorily looked after. All specialising banks keep an account with the Central Reserve Bank and through them it can reach and assist the smallest specialising credit unit in the country.

The Indian Money Markets.

The above analysis will make it abundantly clear that the fully-developed money market is the most vital element in the financial organisation of a country. Coming to our own country we find national as well as local money markets. The former are to be found in the port centres, while the latter are located in the district centres and other interior trading centres. Another hackneyed division of the money market is the oft-quoted one, *i.e.*, European money market and the unorganised indigenous money market.* While the money markets at the port centres consist of both these divisions, those of the interior possess the unorganised indigenous constituents of the money market alone. It has become habitual on the part of writers on Indian Finance to speak of Bombay as "the

* The Bombay Banking Enquiry Committee says that the Gujrati, the Marwari and the Multani Bazars have their different rates. Even in the bazar there is not one rate nor is it adequately controlled at all times by the bank rate.

Lombard Street" of India. But the existence of other national money markets in the chief metropolitan centres cannot be ignored. The close co-operation existing between the two divisions of the money market and the existence of firm money rates as the result of keen competition on the part of specialising units, such as the Multani shroffs, really entitle it to deserve the dignified prestige which the term "Lombard Street of India" actually connotes. It is apparent that most of these money markets do not possess the close-knit organisation which a well-developed money market ought to possess. If the defects of the existing money markets are removed and steps taken to improve the banking system by providing the missing links, *i.e.*, the creation of specialising credit agencies, the lines of advance are open. But I can do no more than mention the salient defects of the existing money markets and indicate the possible remedies. It is for the different credit agencies to decide by what road and at what possible speed they determine to move.

The National and the Local Money Markets.

Some striking qualities differentiate the national from the local money markets of our country. The dominance of the immigrant banking institutions and the sectional character of the credit organisations are the twin features of the national money markets. The local money markets are purely indigenous in

character and are as unorganised as the unorganised indigenous members who form the sole constituents of these money markets.

The Dominance of the Immigrant Banks.

Little need be said to convince you of the detailed nature of the business of these members of the national money markets. All the immigrant banks, be they European, American, Japanese or Dutch in origin, conduct foreign exchange business. Their internal banking business is increasing, though their advances are meant primarily for financing the sea-borne trade. Each sectional agency of the national money market organisation limits itself to a particular class of business and virtually remains independent in its own sphere. The Imperial Bank of India, the foreign immigrant banks, the Indian Joint-Stock Banks, the Co-operative Banks and the indigenous bankers have carved out for themselves respective spheres of their own.

Sectional Organisation of the Money Markets.

Acting as the custodian of the public funds, managing the public debt work and carrying on Government treasury work at all its branches stands the Imperial Bank of India. Controlling the currency chests in every place where it has a branch it facilitates inland remittance and exchange operations.

The financing of internal trade by purchasing demand drafts, drawn against produce despatched, needs no description. The financing of agriculturists indirectly by granting loans on gold ornaments is a new innovation. Caring solely for the stability and fluidity of its resources it has all along been playing the part of a premier commercial bank of the country, coming into constant contact with the Joint-Stock Banks, shroffs or indigenous bankers and the co-operative credit societies. Without believing seriously most of the statements made by its critics it has to be recognised that some good use has been made of the facilities granted to it.*

The Exchange Banks or the immigrant banks specialise in financing sea-borne trade, both import and export. A certain amount of competition has recently appeared both in the field of collecting deposits and in the making of advances and as full particulars of their business are never disclosed it is difficult to discuss the above complaint in all its bearings.†

The Indian Joint-Stock Banks are mostly organised as banking companies and work on conservative lines, adhering to strict commercial

* *See* my Present-Day Banking in India, pp. 48-50 ; also C. B. Enquiry Committee Report—Ch. III and Ch. XVIII.

† Mr. Manu Subedar characterises their advent and manner of working as nothing short of "economic invasion" of India—Ch. XII. and XIII of the Minority Report of the C. B. Enquiry Committee. *See* also my complaints against the Exchange Banks in my written Evidence before the C. B. Enquiry Committee and reproduced in Appendix VII.

banking principles, and attempt to satisfy the needs of their clientele without endangering their position of liquidity.

Next in importance come the indigenous bankers and shroffs who combine trade with banking and do not sometimes hesitate to advance loans on immovable property even. They hardly ever make it a policy to invite deposits. Thus most of the indigenous credit agencies conduct their business with their brains but certainly not with other people's money to such an extent as the modern Joint-Stock Banks do. Even the Multani shroffs who are considered as pure indigenous bankers, though the basic idea of banking, *i.e.*, deliberate inviting and acceptance of deposits, is not to be met with in their case, can scarcely be regarded as modern bankers. Modern indigenous banking instead of specialising in one aspect of credit has contented itself with the small and humble rôle of acting as connecting links between the trading community and the organised banks conducting business on Western lines. Inland exchange and inland remittance form peculiarly the province of the indigenous bankers. Of the agencies specialising in the financing of agriculture, internal trade and small industries of the local areas, these play a predominant part.

The Co-operative Credit Banks, which are a relatively recent innovation attempt to specialise in

making short-term and intermediate credit requirements available to the members of the societies. They have not as yet established a close contact with the money market. Call money is being taken from them by the Exchange Banks, while it is not freely given to the Co-operative Central Banks.

There are many other credit agencies which grant advances to trade, commerce or for other purposes in the urban areas. The most common characteristic of these agencies is that they have not developed their financial system to such an extent as to invite outside deposits to supplement their own resources.

These are the waters of the different or diverse streams of credit, each flowing in its own circumscribed channel and the Imperial Bank, which stands at the apex, vainly strives to collect the waters into a mighty stream or reservoir and distribute it adequately to fertilise the fields of agriculture, trade and industry of the country.

Very Weak Correlation.

There is at present very weak correlation between the operations of these different credit agencies. No system of enlightened co-operation or intelligent co-ordination exists between the Imperial Bank and the indigenous bankers, between the Imperial Bank and the Exchange Banks, between the Exchange Banks and the Indian Joint Stock Banks, between

the Co-operative Banks and the other credit agencies. These different credit agencies work severally and not collectively with the result that there has been no development of an open discount market or a co-ordinated credit policy. This leads to an inelastic system of credit which does not expand or contract in accordance with the interests of the business of the country. Except in the important money markets such as Calcutta, Madras, Bombay, Cawnpore, Rangoon and Karachi, there is no effective liaison between the indigenous money markets and the European money market.

Absence of Intelligent Regulation.

Lacking a genuine Central Reserve Bank, the regulation of the money rates by means of the Bank rate is unknown. Often one witnesses the phenomenon of high bank rates and low call money rates existing in the money markets of our country.* Day-to-day influences do certainly exercise pressure on Inter-Bank call money, but the present Imperial Bank's discount or bank rates are no longer the key rates, since the Government overshadows the money market with supplies of Treasury Bills. There is again no fixed relation between the different money

* "The fact that a call rate of $\frac{3}{4}$ per cent., a hundi rate of 3 per cent., a bank rate of 4 per cent., a Bombay bazar rate for bills of small traders of 10 per cent. can exist simultaneously indicates the extraordinary sluggishness of the flow of credit between the various markets." P. 400, C. B. Enquiry Committee Majority Report.

rates and the bank rate of the Imperial Bank. While the loan and overdraft rates are often made to rise by one per cent. along with successive raisings of the bank rate there is no fixed relationship between the deposit rate of the banks and the Bank rate of the Imperial Bank of India.

Another consequence attendant on the loose and disorganised state of the market arising out of the absence of a Central Reserve Bank is the inelasticity of credit and any extra demand for seasonal currency is not met by the expansion of bank credit except to a limited extent permitted by the cash reserves of the Banks and the seasonal currency expansion permitted by the Paper Currency Act. Lack of tranquility, *i.e.*, frequent changes in the money rates, is the chief result of this feature. The following table shows this feature. There is a great spread between the maximum and minimum bank rates.

Year.	Maximum bank rate per cent.	Minimum bank rate per cent.	Average throughout the year.	Average bank rate first half.	Average bank rate second half.
1921	7	5	5·573	6·038	5·108
1922	8	4	5·821	7·132	4·510
1923	8	4	5·959	7·419	4·5
1924	9	4	6·682	8·05	5·315
1925	7	4	5·643	6·585	4·701
1926	6	4	4·825	5·651	4
1927	7	4	5·732	6·508	4·956
1928	7	5	6·2	6·945	5·456
1929	8	5	6·333	6·878	5·788
1930	7	5	5·892	6·508	5·277

The Government and the Imperial Bank of India act as the dual authorities controlling currency and

credit. Working at cross purposes they generally fail to achieve anything solid in this direction. The Government as currency authority might attempt to deflate or inflate currency according to its understanding of the domestic situation. No easing or tightening of the money market would be resulting if the credit authorities were to deflate or inflate credit just at the same time when the Government is moving in the opposite direction. It is indeed true that the Government of India places the bulk of its treasury balances in the vaults of the Imperial Bank and maintains only a few sub-treasuries of its own in the different portions of the country. But by means of its treasury bill operations and the purchase of sterling the Government of India can influence the money market.

Close Interlacing of Government and Business Finance.

The close interlacing of Government and business finance under the guardianship of the Controller of Currency is another marked feature which does not exist in other countries where the Central Reserve Bank naturally provides remittance facilities and collects the Government revenue. Reference will be made to this feature when the facilities for the transfer of currency would be discussed in the next lecture.

The Lack of Organised Discount Market.

A regularly organised discount market does not exist in any of the money markets. The trade acceptance credit which gives scope for the creation of genuine trade bills has not been adopted in matters of internal trade, though an effective use of the acceptance credit is made in the financing of our foreign trade. The bulk of the credit instruments circulating in the money market should be genuine trade bills, *i.e.*, prime bills arising out of the acceptance credit principle. Indian Joint Stock Banks do not develop this acceptance credit in the matter of financing the internal trade requirements of their approved customers, although they open such acceptance credits on behalf of their customers so far as their sterling requirements are concerned. Suitable credit instruments have not been encouraged and developed either by the Joint Stock Bankers or the indigenous bankers. Without the existence of these credit instruments no co-ordination can exist among the constituent members of the money market.

Lack of Reasonable Resources.

The lack of loanable resources on the part of the banking authorities often compels the Government of India to depend on external capital resources, *i.e.*, sterling loans as well as sterling treasury bills to finance the capital expenditure requirements and short-term needs of the Secretary of State for India.

This shows how imperative it is for us to develop the money power of the country by the existing banking and financial institutions of our country. A prompt reconstruction of our money and capital resources should be undertaken without delay.*

LACK OF MOBILITY OF FUNDS.

There is remarkable lack of free mobility of funds which are generally sent into the interior for the moving of the crops. These funds complete their circuit flow rather slowly. Some portion o the funds finds its way quickly to the neighbouring treasuries and the railway centres. The return to the port centres in time to enable the banks to finance the export bills is not quick. This sluggish circulation of loanable funds in the moffusil has to be remedied. It is not mere increase in the volume of loanable funds that is necessary in the matter of our agricultural finance but an increase in the velocity of circulation of these loanable funds is required.

CONCLUSION.

The question of the reorganisation of the loosely-knit money markets and the provision of the missing

* Of late there has been an increase in the short-term liabilities of the Government Treasury Bills (Rupee) which are being held by the foreign capitalists to the extent of 60 crores of rupees. This increase in the direction of Overseas indebtedness of the Indian Money Market without corresponding assets must serve as a warning that the financial stability of the country is being gravely endangered. A healthy progressive national economy cannot be forthcoming out of increasing hort-term liabilities on the part of the State.

links, such as the bill-broker, the acceptance house, the bill market and a Central Reserve Bank, would tend to make the organisation of the money markets rather compact. The existing credit agencies of the money markets should not only be allowed to exist but proper means for their future development should be chalked out, so that their place in the future banking system of our country is assured and each specialising credit agency should contribute its own quota to evolve a sound and stable national credit system for the country as a whole. Greater efficiency in the money markets can only be realised by increased resources, greater freedom on the part of the C. R. Bank in creating and controlling the banks' cash, and co-operation of the Joint-Stock Banks with the C. R. Bank in making its policy effective.

LECTURE TWO.

(16-1-31)

Expansion and Contraction of Present-Day Currency.

What is Money.

Society depends on exchange and there can be no facilitation of exchange without the regular use of money. Society must have "true" or "good" or "sound money." Though the older economists like J. S. Mill, Jevons and the "Welfare economists" of the American school belittle the economic importance of money and condemn it as one form of base materialism, it has, however, to be candidly recognised that money has become the central interest of modern life and the real part that money plays in a pecuniary society such as ours can best be understood if it is realised that our civilisation, which is solely resting on a cash and credit basis, would receive a set-back, if the value of money, on which the cash and credit system is dependent, became suddenly altered. Money is the pivot round which human ambitions, interests and activities revolve.

Results of Unstable Money.

The contractual basis of the modern economic system would be vitiated if the value of money tended

towards instability. The different classes of society would be affected in different ways if the standard of value does not possess constant purchasing power. As modern large-scale production in society requires long time to produce the finished article, there should be tolerable certainty that unexpected changes in the value of money would not place the various parties to the long-term contracts in a disadvantageous position. Any standard, be it metallic or paper, be it monometallic, or bimetallic or of a composite nature in form, must possess this indispensable quality of steadiness in value over comparatively long periods of time. The value of money, as in the case of most other articles, remains steady if there is neither overproduction nor underproduction with reference to the demand for it. The duty of the currency authorities is neither to oversupply society with money which would lead to a fall in the value of money, *i.e.*, rise of prices of commodities nor undersupply the society with money, for in this case it would raise the value of money, *i.e.*, fall of prices of commodities would take place.

Prompt Elasticity.

The demand for money on the part of any dynamic society would not be the same all throughout the year or a period of years. Seasonal, cyclical, secular or long-period and abnormal changes, such as war would occur in the conditions of society and

the prudence of the currency authority in society must be exercised in such a way that currency is being created in the requisite form and amount and at a cost which is not prohibitive. Any failure in this direction makes the currency system inelastic. Any composite standard for all currency standards are now composite in form cannot hope to promptly expand the metallic form or the standard made to expand to suit the requirements of society. The State is in charge of the standard money or convertible legal tender money that might be issued by it and the banking system is entrusted with the duty of creating this representative money or bank money or cheque currency on the basis of the standard money or convertible legal tender paper money held by them, *i.e.*, the "inherent instability" of bank or credit money is to be held under check by the metallic or standard money or the convertible legal tender money existing in society. But unfortunately excessive adherence to this rigid ratio of legal tender money adopted by the Central banks has tended to retard industrial progress and economic prosperity.

Modern Money is a Three-legged Stool.

Any modern society possesses money which can be aptly compared with a three-legged stool—gold or metallic standard money, legal tender paper money convertible into metallic standard money and deposit currency or cheque currency. It so happens that this third constituent now overshadows the

others and forms six to eight times the size of standard as well* as legal tender paper money, *i.e.*, bank notes. To quote the Right Hon'ble Reginald McKenna "It is the tail that wags the dog." Except for wages and retail payments no metallic money is used. Bank money forms the bulk of the purchasing power media which circulates in any society. All the three constituents can be subjected to inflation or deflation. Gold inflation occurs if more gold mines are discovered. Paper money, *i.e.*, bank note issues become inflated if less gold is kept as reserve. Deposit currency tends to become inflated if a lower cash ratio is adopted by the clearing banks. All these can take place in times of peace no less than in times of war. The same is the case with deflation, be it gold, notes or cheques. Gold deflation takes place if the mines become exhausted. Paper deflation becomes possible, as for example after the war, by resuming gold payments. Credit money is deflated if banks restrict credit. The Government, the gold mines and the banking policies are the chief regulatory influences of the amount and the value of money in any society. This money stream should be kept comparatively steady and must conform to the requirements of demand, *i.e.*, the goods stream produced in any society.

*The machinery of the money market must always be adapted to the progressive changes taking place in the positions occupied by the notes, gold and the cheques. The recent MacMillan Report exhorts the London Money Market to be conforming itself more and more to such rapid changes taking place in the position of gold, notes and cheques.

The Requisites of Sound Money.

The expansibility or contractility of money should be so secured that the value of money is not thereby affected. To be more precise, money in the process of expansion ought not to destroy its own virtue. Paper money and credit inflation would destroy the value of gold money itself as we have seen in the case of the recent War. Steadiness in the value of money is the primary requisite and prompt elasticity of the same to satisfy the genuine requirements of the people in society ought to be the secondary requisite of money.

Without such ideal qualities any kind of money, be it commodity money or paper money or credit currency, cannot produce beneficial consequences on society. Social justice, social contentment and social efficiency are the direct results of the existence of sound money.

Description of the Present-day Currency System of this Country.

Let me descend from the cloud-land of principles to the concrete details of the present currency standard of this country. Considerations of time do not permit me to delve deeply into the historical development of our present currency system. Even the description of the present-day currency system would only be brief and mention would be made of some of its salient features, some of its deficiencies

and a few possible remedies for removing these defects.

The Currency Authority.

The Government of India is the currency authority. It issues the paper rupee currency* which forms a part of our standard money. It manages the gold bullion standard introduced into the country by Act IV of 1927. It undertakes remittance work, exchange work and even banking business.

Our Paper Currency Organisation.

Organised as Government issue in 1861, the present paper currency consisting of the denominations of Rs. 5, 10, 50, 100, 500, 1,000, 10,000 of which the first four denominations are universal legal tender, has been playing an increasing part since 1917 in the currency system of this country. Barring the fiduciary issue which is mostly based on the Government securities, the rest is usually based rupee for rupee on silver and gold coin or bullion. But it could neither be decreased readily in the slack seasons and lean years nor increased readily in busy seasons and periods of emergency. Our paper money neither constituted the bulk of our currency nor did it possess any element giving it the power of

* Although repeated suggestions are being made to remonetise silver, the plan does not seem advisable. *See* Appendix I entitled the Remonetisation of Silver. Paper published in the *Indian Journal of Economics*. See also my articles on the Stabilisation of Silver published in the "Advance."

expansion adequate to meet any seasonal business needs. A kind of currency paralysis was the main disease affecting the nation's business organisation and equipment.

Constant tinkering of the composition of the paper currency reserve enabled the Government to expand our paper currency to satisfy the war-time requirements. But the process of currency education once forced upon the country as a war-time benefit soon proved to be a blessing. Since 1923 the new principle of basing paper money on bills of exchange has been adopted but there has been limited elasticity, which was also obtained at rather a stiff price, *i.e.*, released when the bank rate rose to a high level of six and seven per cent. This rigid inflexible paper currency cannot satisfy our nation's requirements so far as its business continues to depend mainly on agriculture, which requires seasonal expansion and contraction of a highly flexible character. The wasteful policy of separation of reserves, *i.e.*, the gold standard reserve, the paper currency reserve and the cash balances, still exists and a lack of statutory definitions gave scope to constant shifting and ultra-currency uses were very generally performed at least in the past. The idea of a separate trust fund did not exercise much fascination on the Government of India and non-currency uses were developed out of the P. C. Reserve. Even at this late hour too much dependence seems to be placed on silver though the people have of late been

showing their preference to use paper instead of the silver rupee. These are returning from the hoards which are being liquidated.

The Conception of the Gold Bullion Standard.

The other features of the gold bullion standard ought now to be visualised. There is firstly the free movement of gold bullion into and out of the currency system of the country. The silver rupees and notes are convertible into gold bullion. The currency authority has to buy and sell gold bullion at fixed prices in the minimum prescribed limits. The old silver rupee is unlimited legal tender and it is convertible into gold bullion at 1*s.* 6*d.* (gold) ratio for any purpose. The standard monetary unit itself is the imaginary gold rupee of 8·47512 grains of gold in weight. This fixed-weight gold rupee is not minted nor is the gold sovereign nor the half-sovereign legal tender as in the years prior to 1927. There is no Central Bank of Issue which is empowered to act as the sole agent for the Mint or to buy and sell gold bullion for legal tender money at the Mint price of gold. The most essential features of the gold bullion standard are conspicuous by their absence. The market price of gold would always differ if there is an overissue of paper money and in order to see that the market price does not differ from the Mint price, the Bank is always made to buy and sell gold bullion for legal tender money at the Mint price of gold.

If the market price of gold is rising, legal tender notes will be presented to the Central Bank and gold bullion obtained at the fixed Mint price, and this would tend automatically to pull down the market price for gold till it is on a par with the Mint price for gold. The bank note issues would be guided in practice by the market price for gold. It would have to increase the notes if the market price tends to fall. It would have to decrease the notes if the market price for gold showed a tendency to rise. Without this careful issuing of notes the pull on its gold resources cannot be avoided.

The absence of a Central Bank of Issue acting as the sole agent for the Mint means the policy of economising the gold has not been pursued to a great extent. Without this clause the C. R. Bank will not buy and sell gold. Even without this clause the C. R. Bank can sell gold at a fixed price and if the Mint buys gold, people will be able to sell gold to it and secure gold coin from the Mint, provided the Mint is not either closed or the C. R. Bank has refused to buy the gold.

The Defects of the Present-day Gold Bullion Standard.

The vulnerability of the Indian currency system if the price of silver were to rise to 48*d.* an ounce has to be acknowledged. There is too much silver holding in the Paper Currency Reserve, but it must be acknowledged that attempts are being made to sell

silver bullion by the Government of India.* The absence of the important features of a real gold bullion standard makes the critics refer to the present currency standard as the "hardened" gold exchange standard, for the Government can instead of parting with gold bullion give sterling orders in exchange at a fixed price for every rupee. A rate of 1*s*. $5\frac{49}{64}$d. has been notified as the Government's selling rate for sterling to meet these obligations.

The free entry of gold bullion into and out of the currency system has been evidently arranged for under the following provisions which require that the Government should purchase gold at a price of Rs. 21-3-10 per tola of fine gold in the form of bars containing not less than 40 tolas and would sell gold, or, at the option of the Government, sterling for immediate delivery in London at the same price after allowing for the nominal cost of transport from Bombay to London.† The free flow of gold can be impeded if the purchase of sterling is done for the Paper Currency Department (*see* Purchase of Sterling Operations on 14th January 1928). There are

* About 101 millions (fine ounces) of silver were sold by the Government of India since 1927 to the end of March 1931. (Report of the Controller of Currency, 1930-32, p. 12).

† The conditions concerning the sale of gold have been much misunderstood. The costs of importation and of any deviation in the value of currency from its gold parity are to be reckoned by the currency authority. Unless these are added the currency authority would have to sell gold in all ordinary circumstances and then destroy the wholesale bullion market. All this is justifiable, for it is evidently not the duty of the Government to sell gold for non-currency purposes thus burdening itself with another task for which it is least fit.

however instances which go to prove that the tendering of gold bullion to the Government did take place and paper currency was expanded as soon as the rate of exchange rose to the upper gold point. From November 1928 to January 1929 the tender of sovereigns took place and an expansion of one crore of paper currency was secured against gold.

Expansion and Contraction in the Real Gold Bullion Standard.

The expansion and contraction of currency in the real gold bullion standard would take place as follows. Gold bars would be presented and internal money, *i.e.*, notes or rupees, would be expanded against the same. The purchase of gold bars from the Central Bank would tend to draw away internal money and a contraction of the same would follow.

As the present-day Indian Currency Standard is not a real gold bullion standard according to the above description of it, one has to understand the means of expansion or contraction thrown open to the Government, *i.e.*, the currency authority of the country.

Present-day Methods of Securing Expansion.

It is often stated that the Paper Currency system is inelastic by virtue of its being based on the Fixed Fiduciary plan and the non-development of cheque currency has failed to remedy this inelasticity in any radical manner. These self-same critics

point out that the emergency currency provision of 12 crores against *hundies* at a scheduled rate is the only attempt on the part of the Government to provide emergency currency. The minting of rupees is no longer to be done even for Government purposes, for "the gradual dethronement of the rupee" is a settled fact under the gold bullion standard system. Elastic bank paper is no longer the prevailing feature, for the Central Reserve Bank, which ought to issue it, has not been created as yet. So it has often been emphasised by these critics that there is no suitable provision to expand currency even for seasonal requirements.

(*a*) Without entering into any serious criticism of the views of the Government with reference to the supply of emergency currency based on the *hundi* backing during the peak months of the busy season, it must be pointed out that the one and only wish of the Government of India is not to inconvenience the money market by locking up funds and making them unavailable to the money market. The present policy is to keep the barest possible resources in the sub-treasuries and place every available rupee as a bank balance.

(*b*) Besides this making of Government revenue a merchandise product on the part of the bank the policy is to arrange the maturity of the treasury bills in such a way as to pour additional funds into the money market at the time of the busy season. Taking the rate of exchange this day (January 12th,

1931) in the Calcutta Money Market, which can fairly be described as the microcosm of the bigger financial world, it is 1*s*. 5$\frac{3}{4}$*d*. for the rupee. Exchange is far below the gold export point which would not have been the case but for export inactivity and the offer of high rates for treasury bills which are tempting the operators to draw the cheap funds from London for purchasing the Rupee treasury bills. The scarcity of export bills has forced the Government to support exchange by every means. But in other years when export activity was brisk and the financing of export bills meant tightening of the money rates, the policy was always to release funds by the purchase of sterling. The maturity of the treasury bills was also arranged with a view to ease the money position in the busy season.

(*c*) Again, the purchase of sterling releases rupee resources and eases the monetary situation, for it tends to increase the rupee resources of the Exchange Banks while there is a corresponding deficit of their sterling balances in England. Needing rupees in the busy season to buy more export bills they would be too willing to welcome this policy of purchase of sterling, the initiative of which rests with the Controller of Currency. The floating supply of credit can thus be augmented by the purchase of sterling and no acute monetary stringency or panic need be felt. Only mere tightness of money might be evidenced.

(*d*) Further, the tendering of gold bullion or sovereigns in the paper currency reserve and securing

paper currency is feasible as soon as the Exchange Banks find it profitable to import gold into India *i.e.,* as soon as the gold import point is reached. Rupee resources are thereby secured. This principle of issuing notes payable in silver against gold tendered was adopted long ago in 1893 and contributed a good deal towards securing permanent expansion of the domestic currency. Against gold received in England by the Secretary of State for India paper currency was usually released in this country. Again, notes might be issued against the return of Rupees from the circulation. In the year 1930-1931, otes to the value of 1,384 lakhs were created against silver rupees returned from circulation. This is nothing but interchange of one kind of legal tender currency for another.

(*e*) Another method of increasing the Imperial Bank's balances and thereby enabling it to grant additional credit in the busy season, is the transferability of the funds from the Home Treasury in October, November and December to the Indian treasury balance kept in the vaults of the Imperial Bank. This is generally done by placing the sterling securities in the Home branch of the P. C. Reserve and a corresponding expansion is made of the P. C. issued and placed in the hands of the Imperial Bank. During 1923-1924 about 12 crores of cash balances in India were thus added according to the above method. In 1924-1925 six crores worth of British treasury bills were placed in the

Home branch of the P. C. Reserve and currency notes released into the cash balances in India.

(*f*) Paper currency can be issued against the issue of Indian treasury bills. This leads to expansion of paper currency and a discharge of the same would mean contraction.

(*g*) In the previous years the issuing of currency against *ad hoc* securities was freely resorted to. Evidently, it seems to have grown into disfavour, as it ought to be, for it is not based on gold or quasi-gold assets. But there is no knowing whether it may be resorted to in the future or not.

(*h*) If remittance were to be made to the Secretary of State, *i.e.*, Home Treasury through the Paper Currency Reserve instead of the Treasury, inflation would be the result and a corresponding deflation would have to be brought about as early as possible. To be more explicit, when Council drafts were sold and the proceeds credited to the Currency Reserve in London an equivalent amount of notes were released from the Controller's office in India. This could be done since 1905 for the sterling securities or reserve as part of the P. C. Reserve was established in that year. This was done and could be done till 1925 when the new method of the purchase of sterling was adopted.

Finally, the Government of India can increase the fiduciary portion of the note issue by virtue of the 1925 P. C. Amendment Act from 85 crores to 100 crores and thus judiciously expand P. C. in

India to ease the monetary situation. The figure of the fiduciary portion has been fixed at a high maximum and there is the possibility of securing additional P. C. needed for the long periods according to the existing P. C. Act and 1925 amendment of the same. This expansion might be against sterling securities or rupee securities of the Government of India. The principle of proportional system accepted by Government in the P. C. Act of 1920, 1923 and 1925 makes the paper currency system more elastic than it used to be in the pre-war currency system.

Thus there are several methods of expansion which might be taken up according to the feasibility and advisability of the method.* All these avenues of expansion are merely instances of mediæval methods of finance and some of them take on the appearance of "barefaced inflation" of the Printing Press kind, pursued in this country in this enlightened twentieth century. The best way of remedying the inelasticity of currency and credit during the busy season is to create a Central Bank of Issue. Without a Central Bank of Issue consciously managing the currency system in the wider interests of the country, seasonal variations cannot be adequately

* As no additional currency could be created against *ad hocs* and as bills of exchange were not to be had in abundance the practice of creating additional paper currency issue against Government securities deposited in the hand of the Controller of Currency by the Imperial Bank was resorted to. It is anomalous to see why this privilege ought to be extended to the Imperial Bank when the very same bank refuses to lend to the Joint Stock Banks on the self-same securities at favourable rates even during the busy season.

provided for without increasing the cost of the additional accommodation. This is the way in which the Dominions of the British Empire, with the exception of Canada, have solved their emergency currency problems arising out of seasonal variations for currency. But even in Canada additional note-issues can be made during the seasonal quarters by the different banks and elasticity is concerning itself with the growth of the internal trade no less than the external trade. In India, however, it is the external trade requirements alone that are looked after properly by the present-day elasticity. Much more has to be done in this direction before it can be stated that internal trade financing is properly looked after.

So much for expansion. Now let me proceed to discuss the deflationary methods, *i.e.*, methods to contract the currency. Enlightened methods of contraction are necessary for money expanded during the busy season has necessarily to be automatically contracted in the slack season. As it is not bank money with powers of automatic contraction, that is used for seasonal expansion purposes, reliance on prompt return of the expanded funds cannot be placed. Some easily enforcible methods of contraction would have to be developed to drain away the surplus funds acting as a "drug" in the money market.

(*a*) The sale of treasury bills in the money market in the slack season for the purpose of

"mopping" up of the surplus is a recognisable expedient free from criticism, for it is just at that time the Government needs resources to meet its expenditure.

(*b*) The contraction of paper currency issued against *ad hoc* securities or rupee securities is also another well-known phenomenon. In addition to this method, the contraction of currency issued against sterling securities which are transferred to the Home Treasury of the Secretary of State must also be recognised.* The Government contraction of currency during 1930-1931 was to the extent of $40\frac{2}{3}$ crores of rupees and $3\frac{1}{3}$ crores against sterling securities, 29 crores against rupee securities and $8\frac{1}{3}$ crores against gold.

(*c*) The repaying of emergency loans by the Imperial Bank to the Controller of Currency destroys the emergency paper currency issued against internal bills of exchange or *hundies*. Again the Government might suggest the raising of the Imperial Bank rate to a higher figure in spite of a favourable cash position as was done on 30th October 1929.†

(*d*) It is often considered that the sale of treasury bills in larger amounts than the actual maturities during the course of the week leads to

* The Secretary of State needs them for his sterling expenditure and when the sterling securities are transferred to the Home Treasury there is cancellation of paper currency in India.

† The cash balance was at 30 crores and there was no monetary stringency as the call money rate was about two per cent. and the busy season did not commence as yet.

contraction or absorption of currency and credit in the markets. But no definite conclusion can generally be drawn as regards the origin of the funds invested in the rupee treasury bills. If foreigners are interested in the purchase of the rupee treasury bills as a result of their ability to secure cheap funds for a comparatively long period as is the case at present (December 1930) it cannot be inferred under these conditions that a contraction of domestic resources has taken place. The discharge of the Indian treasury bills in the P. C. Reserve however means contraction of currency.

(*e*) The sale of reverse drafts or sterling by the Government leads to the absorption of rupees and paper currency and this contraction leads to a rise in their internal value and the depreciation in the external value would be checked.

The exchange rate tends to become steadied at the gold export point of the country. The policy of rarefying currency by the sale of reverse councils leads to the strengthening of the exchange value of the rupee.

(*f*) If the transfer of gold bullion or silver bullion for sale is pursued, it would bring about the needed contraction of paper currency. A Central Bank pursuing this policy of selling securities to "mop up" the surplus is said to be pursuing the "open market operations". The Government of India is now selling silver as a result of the recommendations of the Hilton Young Commission. This would be

leading to the contraction of silver rupees and paper currency if it were to be done in the closed markets of India. But if silver were to be sold in London and the proceeds utilised for buying liquid gold as a preparatory measure for securing increased gold resources needed as the backing of the cash reserve of the Central Bank it would be welcomed.

So long as deflation of currency is needed as a result of slack business conditions and as a result of the high price-level in the country when compared with other countries and lower physical volume of production in the country there ought to be and there would be no murmur. But forcible deflation to meet such extra-currency ideals as the buttressing of exchange policy *i.e.*, the maintenance of the exchange ratio is bound to be resented and would have its disastrous influence felt on industry and the agriculturists.

"The Goods Stream."

All this expansion and contraction is done without any reference to the "Goods Stream" on the other side. Unless this economic data is compiled with reference to the physical volume of production, the records of unemployment and the statistics of stocks and the Central Banking policies are framed with the above object in view, the attainment of relative stabilisation with all its concomitant advantages would not be realised. The creation of a Central Bank of Issue endowed with the

privilege of elastic note-issue, part of which can be based on trade bills, is essential for tolerable currency stability. It alone can secure the proper information concerning the stocks of goods, the movement of goods into the hands of final purchasers and the velocity of the goods and credit should be controlled in the light of the above data.

Remittance Work of the Government.

It has already been stated that the Government of India undertakes remittance business on a large scale so as to minimise the unnecessary flow of silver money from one part of the country to another. Registered Insured post, the postal money order, the cutting of notes into two halves and sending each by registered post (which has recently been prohibited) are well-known to all students of currency. The Government balances aid the people in the matter of their remittances. Telegraphic transfers (minimum amount Rs. 5,000) are issued against a currency chest or treasury in another place where there is no branch of the Imperial Bank. Supply bills (minimum amount Rs. 1,000) are orders sent by post directing payment from the sub-treasury or treasury balance. Co-operative societies are given the special privilege of making use of remittance transfer receipts. Similarly, those investors who wish to buy or sell Government securities through Government Treasury secure free remittance through free remittance transfer receipts. This interlacing of

Government and business finance is a double blessing. Firstly, it enables the Government to transfer revenue from inland centres to the metropolitan centres where the bulk of its expenditure has to be incurred, and secondly, the commercial public who wish to have their money in the inland centres would be willing to close with the Government offers.

Cheap and Speedy Means of Remittance.

Considering the vast extent of the territory and the present inadequate facilities for the speedy remittance of money at cheap rates, it is advisable that a well developed banking system should take up this work and transfers through banks would be far better than anything else. It is indeed true that postal orders, postal cheque accounts, giro accounts and postal traveller's letters of credit, reduction in the amount of currency transfers from Rs. 5,000 to Rs. 1,000 limit and in the case of supply bills from Rs. 1,000 to rupees 500 (and even broken amounts should be transferred under these headings) can be developed as cheap and suitable means of remittance, but these are inferior to bank drafts and cheques and bills of exchange which can be cleared and collected through a Clearing House System which acts as a collecting agency at the same time.

Central Bank of Issue.

A Central Bank in charge of the Clearing House system which clears not only cheques as at present,

but bills, *hundies* and other instruments of remittances and an extended use of credit instruments such as promissory notes, cheques, bank drafts, standardised bilingual *hundies* and bills of exchange would afford the cheap and rapid service needed for the transmission of money. The existing co-operative banks should play greater part in the free remittance transfer business. The old expensive and risky method of physical transportation of money by rail resorted to by the indigenous bankers can and ought to be given up as early as possible. Supply bills and currency transfers would no longer be needed, if the Central Reserve Bank takes up every treasury and control over the currency chests is concentrated in its hands or performed by its selected agent—the Imperial Bank of India. Government remittance becomes part and parcel of the wider problem, *viz.*, Inland remittance. Diffused and widespread banking under the controlling influence of the Central Reserve Bank is the only intelligent panacea in the matter of providing cheap and speedy remittance facilities in this vast continent where distances are very great. It is then alone that the present unfair advantage of the Imperial Bank which lies in its control of the currency chest and which is not being shared, somewhat, equitably with other banks can be eliminated. The Co-operative Banks assert that the Imperial Bank refuses to encourage the Central Banks as remittance agents for the indigenous bankers and local traders. But any unwarranted encroachment on commercial banking

forsaking the co-operative ideals has to be rightly discouraged. (*See* the Bombay Provincial Banking Enquiry Committee. *See* pp. 144 to 147.) The expansion and contraction of bank money at a comparatively steady bank rate can be brought about by the Central Bank. Its agencies and its branches in the different provinces would enable it to render unnecessary the transfer of metallic currency from place to place. This economising of currency would greatly increase the utility of the existing amount of currency.

However great the ultimate benefits of the Central Bank would be in the matter of providing adequate credit currency to suit the requirements of agriculture, industry and trade, the immediate benefits in this direction do not seem to be very alluring. The Central Reserve Bank cannot hope to control the movements in the money markets, for most of the changes arise as a result of want of confidence in exchange, precariousness of credit and consequent withdrawal of native capital from circulation in the bazar. These abnormal changes cannot adequately be controlled and fluctuations in our bank rates and money rates would still appear. It is a peculiar characteristic of present-day India that both monetary demand and supply vary very greatly and fluctuations in money rates are greater in this country than anywhere else. The evolution of sound and efficient methods of business organisation and industrial management would mitigate this

evil. Until this happens the Indian banks cannot hope to control all these different conditions and Indian Bank rates cannot hope to remain so tranquil or steady as is the case with bank rates in the Western countries where reasons for the credit strain or disturbance or money market problems, as they can be designated, can be foreseen and prevented by timely action. Lacking the three most important data, regarding the physical volume of production, the movement of stock prices, commodity prices and total bank credit which have wide influence on general economic conditions, the Central Bank would be unable to exercise its pull in securing stable conditions of economic life during the early years of its existence. But the perfection of this economic data by its own staff would form a landmark by itself.

Improved Credit System is the only Panacea.

But it is an undeniable truth to assert that an improved credit system can solve some of the currency ills of the country. The much needed elasticity can be secured when the issuing of notes is handed over to the Central Bank of Issue. Banking extension makes for economy in metallic reserves so far as they are needed for domestic exchange. The highest currency ideal is to circulate a paper token instead of full value metallic coins and the best way of approaching the ideal is to circulate bank notes based on assets which include bills of exchange representing short-term industrial, commercial and

agricultural transactions or bankers' acceptances. With the progress of monetary science and the development of new banking policies, superfluous coins have been dropped in other countries and the same thing doubtless would be the feature of evolution in this country. The silver rupee would ultimately be dropped and liberal measures for securing elasticity of currency would be enacted.

LECTURE THREE.

(30-1-31)

OTHER MONETARY MARKETS.

The broad term "money market" refers to the market where money is bought and sold. Just as there are various kinds of money, such as money on the spot, *i.e.*, current account at the bank and a bill of exchange payable at a future date, there are different monetary markets dealing with such kinds of money. The money market itself does the main business of converting money due at some future date into money on the spot. The one form of money is converted into another form of money.

The bill of exchange represents money due at future date. These bills are converted into money on the spot. Another monetary market is the Foreign Exchange market where domestic money of the country is converted into foreign money. Our rupee is exchanged into money of some other place.

The investment market or the long-term capital market is the place where the borrower needing

long-term loans secures it from the savers by paying a certain rate of interest. In a well-organised community the lenders can hope to secure a fair rate of interest from the borrowers, whether individuals or joint stock companies. The State and other groups of individuals might be forced to pay a certain rate of interest, and all attempts to secure extortionate rates of interest would very soon be curbed by the State. The most important market, where lending and borrowing is generally done in the most refined manner, is the Stock Exchange. The savings of the people are generally invested in industrial activity through the help of this machinery and the joint-stock form of enterprise. The person who wishes to withdraw his money from the industrial or other form of activity can promptly sell his stock or share to a person who desires to find a lucrative form of investment for his savings.

These markets revolve round the Money Market and the rates in the different markets are susceptible to the influences of the money rates prevailing in the Money Market. It would be the main endeavour in this lecture to trace the influences and the chief contrary forces that tend to exert their pressure in these different monetary markets. The necessity for developing these useful auxiliaries must be understood and the money market itself would refuse to function smoothly in the event of their non-development and lack of co-operation with the members of the money market.

THE BILL MARKET.

While analysing the composite term the "money rates" we referred to the bill or discount rate as apart from call money rates, the bank rate, the deposit rate, and the loan rates. Even the expression "the discount rate" is not a uniform expression. The chief discount rate quoted in the London Money Market is the rate of discount on three month's bank bills. This is the oft-referred to "Market rate." Thus there are several discount rates for the different classes of bills, such as bank bills and trade bills. Broadly speaking, the discount rates closely follow the short-term loan rates and are higher than the call money rates. Discount rates are higher in the case of less secure bills or bills of longer standing or "tenour" as the technical jargon puts it. If the demand of the bankers and other buyers is great for commercial bills of a particular tenour, the buyers would keenly bid for them and commercial bills fetch a high price. At certain periods they fetch higher prices than treasury bills, *i.e.*, lower discount rates might prevail than the treasury bill rate. In November 1926, the treasury bill rate was higher than commercial bill rates in the London Money Market, for the demand was greater than the actual supply. The trade depression tended to diminish the supply while the Continental demand for commercial bills forced the buyers to pay higher prices. They could not take the sterling treasury bills even, for they did not contain the two or in some

cases the three endorsements needed for their portfolio.

The Link Between the Discount Rates and the Call Money Rates.

Call money or short-loan rate as it is usually referred to cannot but influence the market rate of discount, for the bill brokers borrow their supply from the banks. Cheap call money,* which generally arises, if the Clearing Banks reduce the day-to-day money rate, brings down discount rates to the lowest figure. The assurance of comfortable monetary conditions ahead for some time would make discount rates touch rock bottom level. Bill-broking tends to be unprofitable and stale when short-term money rates tend to be low and wipe out the margin between the bill rates and the call money rates. As the Central Bank stands ready to buy unlimited quantities of fine bills at the bank rate, the market rate of discount for these will never be higher than the bank rate. It can be lower than the bank rate if the mammoth Joint-Stock Banks make an effective bid for bills which are rightly considered as the best self-liquidating instruments.

As soon as monetary pressure is exercised, the discount rates, *i.e.*, the open market rates, jump

* Theoretically speaking call money is repayable at the option of either the lender or the borrower and tends to approximate towards bank's demand deposit or current account rate.

up and attain a high level. The treasury's influence on the short-term loan fund will also have to be studied while explaining the behaviour of the open market rates.

The floating of the treasury bills tends to make money scarce and firm bill rates will ensue. The good showing made by the currency in the foreign exchange markets would force down discount rates to a low level. If exchange is adverse and gold leaves the shores, money stringency will arise and the bill rates will rise to a high level. Similarly, if the demand for bills were to be augmented, the discount rate will be forced down. The presence of a Central Bank would mean that there is a leader who fixes the rates of interest and discount that would prevail in the money market and in the banking system of the country as a whole.

Absence of a Bill Market in this Country.

Verily, has it been stated that "where ignorance is bliss it is folly to be wise." Unfortunately for the student of Indian Banking there are not very many opportunities to gauge the diverse and sometimes contrary influences of various factors on the bill rates. But he cannot congratulate himself on his ignorance in these technical matters; for without a bill market there cannot be any well-developed money market. Even in the somewhat better organised national money markets of Bombay or

Calcutta there is hardly a bill market. Rediscounting of "approved" bills even by the Indian Joint Stock Banks does not exist to a great extent. The following table will illustrate my remark.

The business of the Imperial Bank.		Percentage of business with banks to total business.
Current Account	...	26
Fixed Deposits	...	½
Bills	...	0
Cash Credits	...	2
Overdrafts	...	7
Loans	...	31

(*See* the Report of the Bengal Banking Enquiry Committee—p. 40).

This banker's bank does nothing in the direction of rediscounting the bills of the Joint Stock Banks so far as the Calcutta money market is concerned. Rediscounting is considered a weak sign.* Besides they would thereby be placing the secrets of the bill portfolio in the hands of the competing bank. They buy but do not sell *hundies* or bills of exchange. Like the English Joint Stock Banks, Indian Joint Stock Banks are too proud to borrow from the Imperial Bank by means of rediscounting, that is, modern Central Banking practice does not exist.

* *See* the evidence of Mr. S. N. Pochakanawala before the C. B. Enquiry Committee.

But unfortunately they cannot, like the English Joint Stock Banks, compel the market to borrow from the Central Bank, for unfortunately in this country there is neither a money market nor a Central Reserve Bank following modern Central Banking practice. In dire and emergent circumstances alone, they would borrow from the Imperial Bank on the strength of Government securities.

Coming to the original discounting business itself, there are few traders' acceptances even and bills have not arisen in the matter of internal trade. Banks have not developed the acceptance business in the matter of financing domestic trade. Bills arise in the matter of our foreign trade and these are bought by the exchange banks without any difficulty. As the representatives of the Exchange Banks Association have stated in their oral evidence before the Central Banking Committee the export bills of all sound merchants are eagerly bought by the Exchange Banks. The creation of a discount market would, however, increase these facilities.

Bankers' Acceptances.

The bill market primarily means the bankers' acceptance market. Without bills it would not be possible to develop the acceptance function of the banks in our money market. With a change in the mercantile habits, this modern form of expressing commercial indebtedness can easily be adopted. Cash credit and the open book-credit system would

undoubtedly have to be given up by the merchants. In the absence of a C. R. Bank to buy the bank acceptances, banks would naturally be conservative in extending their acceptance function.

MEASURES TO DEVELOP THE BILL HABIT.

It is a matter of gratification to find that almost all the Provincial Banking Enquiry Committees have recommended the self-same measures to develop the bill habit which I had the opportunity to offer long ago in an article entitled the "Inland Bills of Exchange" published in the *Calcutta Review* in April 1928. Barring the suggestion of differential rates for discounts and loans, which the Central Reserve Bank ought to allow, every other suggestion of mine has been incorporated. The Central Banking Enquiry Committee would, however, endorse this suggestion, for without this tendency no positive encouragement to draw bills would really exist.

In addition to those, which I offered long ago (*vide* my Article) I consider it essential to adopt the following measures for the achievement of the same object. Some propaganda work as regards the benefits arising out of the bill habit to the banks, the buyers and sellers of goods would do signal service in this direction but apart from this primary change in habits the number of competing specialising agencies who require secure and liquid short-term investments and who buy and sell these bank and

trade bills ought to increase.* It should be borne in mind that the bill market as well as the call money market are really speaking "two way" markets. Bills can be sold as well as bought. Such incidental measures as the reduction, if not abolition, of the stamp duty which comes up to 9 annas per cent. per annum and the sale of standardised bilingual bill forms would have to be undertaken. Bills must be utilised to finance the movement and storage of goods in licensed warehouses which have to be created, if orderly co-operative marketing of our prime staples is to be an accepted feature on the part of the primary co-operative producers' societies or the literate primary drawers of drafts. It is then alone that the co-operative sale and purchase societies and the co-operative credit societies can hope to tap the wider money market by passing on the bills endorsed by them. Local financial resources can thus be augmented by the resources of bigger banks willing to discount or re-discount these bills endorsed by such organised associations or the indigenous bankers who may elect to specialise the bill-broking business. Free movements of funds according to the necessities of the districts can thereby be ensured. The financing of agriculture which is now not being attempted in any direct manner by

* The charges for discounting bills would thereby become lowered. *See* the evidence of the representative of the Ahmedabad Millowners' Association before the Central Banking Enquiry Committee. A Clearing House for bills in all the important centres will reduce the commission charges which banks make in collecting the proceeds of bills.

the Joint Stock Banks, would become an accomplished fact under the discount banking system. The money market would derive solid benefit by the ultra-commercial uses of credit being dispensed with in the presence of an organised discount market. A rapproachement between international banking and financing agencies and the domestic bill markets and the banking system would arise. We hear already that foreign money is being willingly invested in our rupee treasury bills. With prime bank bills this financial nexus will be strengthened further and further. The holding of rupee bills would increase the contact with the domestic banks and would transform them into well-known agencies in the international money market. The realisation of these advantages is solely contingent on the fact that the mere acceptance of two-name paper without proper credit information of the parties responsible for the payment of the bill is not light-heartedly undertaken. If people of questionable standing were to draw the bills, the credit risk is great, and banks which discount such trade acceptances would likely suffer grievously by having paper which cannot be converted into liquid money. The scrutinising of the credit standing of the parties to the bill, should neither be neglected nor minimised. Even this precaution will not by itself go far in developing the open discount market. The keys to the money market are the bill-broker and the Central Reserve Banker. Find the two keys and you will find the money market.

The Exchange Market.

The relationship between the foreign exchange market and the money market would have to be understood. It has already been stated that firm exchange rates tend to lower down the discount or the open market rate. Unsteady and adverse exchanges leading to gold efflux would tend to tighten money and this would raise the discount rates or the open market rates.

Government's Control over Exchange.

Lacking the Central Bank regulation of the exchange situation, neither the Indian traders nor the general public understand aright the full significance of the Government control of the exchanges. Having selected stable exchange as our policy, the Government of India are bound, in the last resort, to maintain the rupee at the selected ratio, *i.e.*, 1*s*. 6*d*. (gold) Everything would be subordinated towards this stability of exchange. Distinguished economists have rightly pointed out that the choice lies between a stable exchange at the expense of fluctuating internal prices or stable internal prices with fluctuating exchange during times of international disturbances. Even economically advanced countries like the U. S. A., have given up the problem of securing *absolute* stability of internal prices nor have they allowed "exchange to go hang" as Prof. Cannan would put it. Economic theorists as well

as practical statesmen now realise that comparative stability of the exchanges is much more easy to attain than a corresponding stability of the internal price-level during times of international instability.

THE MAINTENANCE OF THE RATIO.

Having selected the stable exchange policy as their ideal the Government of India inflate or deflate currency with the view of maintaining it —although the circumstances of the money market might point out the necessity of pursuing the opposite path. In the midst of the busy season, if exchange tends to slacken, there would be "disastrous contraction" of currency, as businessmen, who dislike tight money, would term it. The sale of treasury bills would absorb money. The raising of the bank rate even though the cash situation of the Imperial Bank is safe or even when money rates are easy in the open market, would be pitched upon to buttress the exchange policy. In order to make the bank rate effective, the policy of selling treasury bills at high rates would be pursued. The main object of these different measures is to prevent exchange from sagging below the gold export point from the country. Thus considerations of the price-level and the monetary requirements of the borrowing public do not weigh sufficiently strongly at such times. The Hilton Young Commission rightly pointed out that this Government control of exchange and currency would have to be given up, and the Central

Reserve Bank which manages the Gold Bullion Standard would regulate exchange. As the gold standard would be in existence, the currencies between England, the other important trading countries and India would be the same. The movements of the purchasing power parity will be very small. A common standard would, by itself, bring about comparative agreement in price-levels, hence the movements of purchasing power parity will be very small. If the balance of indebtedness is in favour of this country, the imported gold bullion would be presented or potential balances would be raised abroad and the local currency released by the Central Reserve Bank. As central authority it has to keep a running account with the important trading countries, and if these balances of foreign currency are accumulated these can be sold or utilised in days of unfavourable balance. The increase of credit money or decrease of it would take place under the ægis of the central authority, *i.e.*, the Central Reserve Bank. If the Government were to be the exchange authority, it would release legal tender money when it is buying or purchasing a bill or foreign currency and a sale of the reverse bill means decrease of the domestic legal tender money. A Central Bank's control over exchange would leave the legal tender money, the same as before, until gold is actually exported from the country. Expediency as well as safety point out that a Central Reserve Bank management of the exchange situation would be superior to that of

Government management of the same. The gold standard itself gives stable exchanges within comparatively narrow limits and the C. R. Bank has to manage this standard in the wider interests of the country as well as the outer world.

The Government of India would be emancipated from special problems as the purchase of sterling, the sale of reverse bills and the securing of enough Home balances in London, to meet the Secretary of State's and the High Commissioner's requirements and the undertaking of measures to make the bank rate effective. The Bank rate is strengthened by floating treasury bills at slightly higher rates. A seven per cent. Bank rate is now being strengthened or implemented by a policy of selling treasury bills at 6·2 per cent. (so far as intermediates are concerned—January 1931). Without an effective bank rate, the ready exchange will not rise by $\frac{1}{32}$ *d.* at least above the gold point.

Remittance Problem.

Just as banks should be the best agencies for performing the internal remittance work,* so also the remittance of funds to London should be understood as genuine banking business and be left to the Central Reserve Bank, *i.e.*, the Government banker. The Government's policy of "purchase of sterling" has evidently failed, for to purchase sterling at the

* Internal remittance is almost done free of charge by the Canadian Panks in case of distances below 400 miles.

low rate of 1*s.* $5\frac{3}{4}$*d.*, would have been a very costly matter and would have defeated their aim of exchange stabilisation. Of the £$31\frac{1}{2}$ million budgeted for, only £$5\frac{1}{2}$ million have been secured by the purchase of sterling (January 3rd, 1931). As the exchange level of the rupee has never touched, the gold parity, *i.e.*, 1*s.* 6*d.*, there could be no large-scale purchases of sterling, for if heavy Government demand were to arise in the absence of export bills, the exchange rate would fall further and further. The Government were practically forced, by virtue of the stable exchange policy, they have been maintaining to recede from the market. The floating of loans in London to meet the needs of the Secretary of State has been resorted to, to keep him supplied with funds. The ways and the means advances from the London branch of the Imperial Bank have also helped them to a certain extent. But the best method is to create the Central Reserve Bank and enable the London branch of it to have a small portion of its exchange funds to finance the Secretary of State and the High Commissioner's requirements. This portion of the reserve must enable the Central Reserve Bank to pay the Home charges only when the exchange rate prevents the purchase of sterling from the money market. (*See* my article, entitled Purchase of Sterling—*The Calcutta Review*, Nov. Dec. Number, 1928). The London balance of the C. R. Bank need not be substantial enough to liquidate an unfavourable trade balance to the extent necessary to prevent

exchange from falling below the gold export point from the country. A Central Bank's supporting of the exchange would mean releasing gold bullion for the internal currency and the gold bullion reserve would be needed in India. A Central Reserve Bank, issuing currency, controlling credit, regulating exchange, undertaking remittance and Government banking work, can alone hope to remedy the present-day situation and confer banking and monetary autonomy on the country.

The Investment Market.

The investment habit is being implanted slowly in the minds of the Indian savers, the small as well as the rich. The growth of the Post Office Cash-certificates, the repatriation by purchase of the London-enfaced rupee paper and its absorption by the Indian money-market, the increase in the Post Office Savings Bank deposits, the increased subscriptions to the rupee loans floated by the Government of India and the quasi-local bodies, and Indian subscriptions to the sterling loans of the Secretary of State, the increase in Co-operative and other Bank deposits and the increase in Joint Stock capital speak directly for the amount of progress in the investment habits of the people. Some indirect proofs as regards the increase of the investment habit of the people are the wide spread of the banking net-work under the pioneering attempts of the Imperial Bank, the

development of other kinds of financial institutions, and improvements in the working organisation of the stock exchanges. There is, however, a large amount of frozen capital which has to be gathered so that our indigenous capital supply would equal the demand for the same and enable us to repay our present-day external debt, which amounts to £382 million roughly. It is the duty of the money market to play a significant part and a conspicuous rôle in mobilising and conserving the capital resources of the country. Equally important is the duty of checking the export of capital from the country until the home demand has been adequately satisfied.

The Present-day Means of Investment.

The Government of India have been doing their level best to facilitate the investment of savings on the part of the small savers.* The Post Office Savings Bank, the Post Office Cash Certificates, the encouragement in the matter of buying or selling Government securities through the Post Offices and the wide-spread advertisement of the Government rupee loans, when floated in the slack season, are the

* Since these lines have been written the Government of India have increased the rate of interest paid to the holders of the P. O. Cash Certificates, since Sept, 1930. The floatation of treasury bonds on the tap system and the appeal to the small investor to seek the aid of the Post Office in subscribing and collecting the tax-free interest is noteworthy. As in the case of 1930 loans, when 83 per cent. of the total number of applications came from the small investors, so also in the matter of the treasury bonds it would be the small investors who would subscribe through the Post Office. A wide advertisement of the fact that nearly 7½ per cent. real return would accrue by the holding of the Treasury Bond is needed at the presen moment.

methods pursued by the Government to cajole the small investor and induce him to give up the old and unfertile channels of investment of his savings in land or jewellery.

The expert opinion of a recent American Commission seems to incline to the view that "the amount of precious metals stored in India is equal to that held by the United States," but in India this wealth is immobilised and rendered sterile by the unwise habit of hoarding or locking it up in the shape of ornaments. The main problem is how to gather these "small dormant hoards" and increase the capital supply of the country.

The Small Investors.

The offering of higher rates of interest, the liberalising of the facilities for the small investors through the Post Office—specially in the matter of P. O. Cash Certificates, the advertising through the Post Offices of the floatation of the tax-free loans (and keeping open this Post-Office section for a longer period than the other one), the issuing of short-term bonds which are more popular than the long-term loans are some of the most important measures which have to be undertaken to mobilise the savings of the small investors. Tapping the wider area of the entire country even by paying a higher rate of interest to the small savers is far more preferable to the intense drive on the part of the Government for making the rupee loans

successful when floated in the money market during the slack season. Withdrawal of money by Government borrowing would force the bank rate up and would levy a fine on the legitimate traders and borrowers borrowing in the money market.

The rural Co-operative Banks, the Indian Joint Stock Banks and the Imperial Bank and the few Stock Exchanges that exist are doubtless doing their best in the direction of mobilising the savings and spreading the investment habit amongst the small savers. All this is uncoordinated effort without any consistent aims properly chalked out in the wider interests of the country.

The flight of capital abroad is a noteworthy feature.* Investors or banks might send their capital to earn higher rates of interest prevalent abroad. The solemn obligation of liquidating our past obligations to external capitalists falls on our shoulders. The directing of the flow of the present savings which itself has to be augmented to a great extent by productive efficiency, and the mobilising of "the immobilised wealth," and the wise investment of the annual importation of precious metals into this country through the existing financial machinery or the creation of new machineries are the chief problems of the investment market in this country. The mere inculcating of the doctrine of thrift, which itself is not being done scientifically at present in

* *See* my article "Can India become a creditor country?" Paper read before the Annual meeting of the Indian Economic Association—January.

this country, would not suffice. Investment is a science. Specialisation in this business is absolutely essential to inspire confidence in the minds of the people. If such highly qualified bodies were to direct effective propaganda for the realisation of the above aims, they would be crowned with success. Sir Joseph Burns has rightly remarked that "the teaching of thrift" and the principles of right investment (I would add) "is absolutely necessary in this country". The desirability of thrift must be taught to all, the rich and the poor, the old as well as the young, the male as well as the female. The mere evincing of the desire to save would not be attendant with great advantages unless these organisations invest the pooled sources of savings of the smaller classes. The Indian investors do not clearly understand the real significance of discounts, premiums, or conversion terms and "deferred investment" but there would be no hesitation on their part to subscribe to the short-term or long-term loans of the Government.

Investment Trusts.

If our salvation depends on specialisation, it is high time that the specialising institutions of the nature of Investment Trusts were created. I have elsewhere recommended the formation of such trusts on the model of the English type. (*See* Present-day Banking in India, Third Edition, pp. 615 to 626). While I was tendering oral evidence before the

Central Banking Enquiry Committee at Poona, Sir Bhupendranath Mitra opined "that times are not propitious for the growth of these bodies". The rate of interest being high in our rural areas there is not much scope for these new bodies to earn this high rate. It is undoubtedly true that the English Investment Trusts arose at a time when the rate of interest was very low and the cult of the share as equally safe and more paying than the Government bonds could be successfully taught at that time. It also enabled the proper external investments of the English savers to be made on safe and sound lines. Though our present-day ambition is not to make India a creditor country, still we do require these institutions or National Savings Associations started in order to have a systematic drive as in the case of the United Kingdom. The National Savings Committee just the other day presented the thousand millionth certificate to His Majesty the King Emperor. The War Savings Certificates were the original certificates and the movement has not been relaxed although the war terminated long ago. The work of the N. S. Committee is to start new Savings Associations, to form local committees to convene regional conferences, to hold a National Savings Assembly, to invite eminent speakers to help the movement, to frame new savings schemes, to keep in touch with employers and others likely to make use of new proposals and to co-operate with bodies in fostering the thrift movement. (*See* the Report—National Savings Committee—Report of 1928-29).

Even employee ownership of these certificates has been popularised through joint contributions of the employer and the employee.

The Board of National Investment.

The work of the Investment Trusts or such N. S. Associations can best be co-ordinated and supervised by a National Board of Investment. The issuing of the gold cash certificates can be undertaken by it. The issuing of the bearer bonds at Rs. 3-14-0, repayable five years later and being encashable at intermediate rates, with quarterly encashments, is another suggestive feature which can be taken up by this wider body. (*See* the Madras Provincial Banking Enquiry Committee Report.) It is indeed true that the habit of "deferred investment" is not existing and debentures are not very popular with the Indian investor. If an authoritative and competent body were to be started and debentures issued under its ægis, people will gradually acquire this habit. Our annual capital requirements of the different Governments and local bodies amount to roughly 60 crores. As far as possible the object of the Government should be to secure as large a portion of this amount as is possible for it to do, through the permanent savings of the small investors. Dependence on the money market would mean lesser available resources for trade and industry. The withdrawal of fresh money from the money market would mean high bank rates. This can be

avoided safely by the thrift campaign organised by the Board of National Investment. While this is the immediate problem ahead, the Board has to organise the immobilised wealth and when the accumulated resources are far greater than the above requirements, the repayment of external debt can be taken up. The interest payments that would be made on the Government indebtedness would give scope for the accumulation of internal capital resources. The helping of the existing industries with long-term loans can be undertaken with any surplus capital which might be available after supplying the above requirements. Having understood the advantages of co-ordinated borrowing by the Central Government for all purposes, the policy of co-ordinated efforts by the Board of National Investment can easily be inaugurated.

The Perfection of Stock Exchanges.

The creation of more Stock Exchanges, as at Cawnpore, and other major industrial and trading centres and the perfection of the existing Stock Exchanges, can be undertaken with the object of increasing the investment habit and providing markets where the lender and the borrower can meet on a footing of economic equality.

Taking the Calcutta Stock Exchange into account, its main business consists in buying and selling shares. There are no settlement days, delivery is due the second day after the contract is passed and

sales of securities are effected for the most part under blank transfers. There is no distinction, as in London, between the jobber and the broker. The Calcutta brokers are brokers as well as jobbers. Although this system can be allowed to exist, the institution of fortnightly settlements or monthly settlements seems desirable, as it introduces order in the stock exchange operations of the speculators. The operations on "bear account" would become penalised relatively to those which are conducted for a rise, for with daily or short-period settlements the former require much larger financial resources than the latter. Forced selling in order to satisfy the system of daily or short-period settlements becomes the rule and the slump becomes aggravated as a result of this daily settlement. The restraining action of the bear operations tends to place a natural check to the high level of prices to which shares and stocks may be carried away by the speculator. I am not oblivious of the fact that the calls for money on the part of the Stock Exchange operators would be more frequent under the system of daily settlements and the call money rates fluctuate more actively under this system than the one under the monthly or the fortnightly settlements.

Considerations of time preclude me from outlining the other suggestions for improving the Stock Exchanges. These as well as other agencies which are at present existing ought to be able to tap more savings which increase the volume of available savings

awaiting investment. The volume of investment should proceed hand in hand with the volume of savings. The cost and volume of the investment should also be influenced by the banking system at the dictates of the Central Reserve Bank. The rate of investment, *i.e.*, the rate of long-term interest, must be made co-equal with the natural rate of interest. Through the short-term money rate the long-term rates can be influenced. Cheap money and the assurance of continuous supply of it in the near future would engender confidence and speed up the processes of investment and the industrial slump or depression would pass away, if other things tend to remain the same. The rigour of industrial fluctuations can thus be checked by the forestalling action of the Central Reserve Bank.

By promoting banking stability it can indirectly help to mobilise effectively India's potential capital resources. By rediscounting the short-term Government paper, as is done by the Federal Reserve Banks, it can create popularity for this form of investment.* A sound ways and means position can be developed as a result of the successful operations of the Central Reserve Bank. The Central Reserve Bank can aid the Government of India or the National Board of Investment, if these were to tap the money market for temporary or permanent loans.

* *See* Appendix III.—Article entitled "Some Salient Lessons, etc."

LECTURE FOUR.

(13-2-30)

THE IDEAL MONETARY AND BANKING SYSTEM.

Indian monetary and banking system should be based on modern central reserve banking practice and the independent gold rupee standard ought to be worked in such a way as to free it from undesirable international influences, such as a fall in the price of silver or a threatened shortage of gold. The gold rupee note should expand and contract with the physical volume of production. The credit money created by the Central Reserve Bank and the banking system as a whole need not depend on gold commodity money and evidences of gilt-edged instruments or Government indebtedness alone. The gold rupee-note can measure value and the holder can convert it into any other article needed by him. Production gives rise to bank credit and bank credit forms the most important form of society's money. The promotion and intensification of national production being the object of the national monetary system, the Central Reserve Banking practice should be carried out with the above object in view. Holding a fixed maximum

limit of gold reserve * and not a ratio of the amount of note-issue and sight liabilities, as is the case at present with some of the Central Banks, our Central Reserve Bank should issue bank currency notes against commercial bills arising out of wealth products. This bank currency should have nothing to do with the gold held in its vaults or short-term foreign balances held by the Central Bank in foreign markets. But the notes can be issued against gold presented, and the Central Reserve Bank can fix the price of gold at certain points and thus tend to stabilise exchanges by providing forward gold markets and altering the gold rates when there is a lasting disturbance in the relation between the internal and the external price-levels. This way of consciously managing the bank money and partial demonetisation of gold by closing the mints to gold would become inevitable as the shortage of gold becomes more and more acute. Most of the debtor countries are already off the gold standard.

A discriminatory or differentiating rate should be applied to the financial bills by the ordinary Joint-

* It is a matter of sincere gratification to record that the MacMillan Report also endorses this view. It says that the independence of the note-issue and the gold reserve ought to be recognised. Not only is it necessary in England but all other countries should adopt the same measure. We heartily endorse its opinion, which says that "if the view could be generally adopted that gold reserves to-day are held solely to meet temporary deficiencies in the balance of international payments and if their amounts were determined by what was reasonably necessary for the purpose this would be the greatest safeguard we can imagine against the risks of a future shortage in the supplies of gold relative to the natural growth of the world's money income." *See* the MacMillan Committee Report on Finance and Industry.—Cmd.—3897, 1931.

Stock Banks and these should not be rediscounted by the Central Reserve Bank.* All industries, agriculture and manufactures should have access to the Central Reserve Bank for rediscount facilities through their special financing agencies and the ordinary market rate of discount should be fixed in accordance with the Central Reserve Bank's rediscount rate. As production increases, the money increases, *i.e.*, currency is created against bills of exchange representing natural wealth products. As the quantity of cheap sound money, originating in production and terminating in consumption, increases, the price of money will become cheap and this tends to reduce the level of cost of production. Falling prices would be brought about by falling cost of production. The whole monetary system should be actuated with this sole motive, *i.e.*, helping legitimate production and the increasing of the national wealth products. It should not again destroy the real basis of exchange, *i.e.*, barter economy. Economic theorists are right in their contention that national or international trade should solely rest on the principles of barter economy. The monetary system consisting wholly of well-regulated paper currency must eliminate deflation and inflation and measure every variation in other commodities produced by the nation. The more the real national dividend is, the more there is for division and more wealth is divided among the wage-earners. Rising

* For the needed clues for differentiating the one from the other *see* my *Elementary Banking*—Chap. on "Discounting."

wages and falling prices would be realised in this society. The doyen of the English Economists, the late Dr. Marshall, pointed out long ago, that society would be happy under a regime of slowly falling prices, arising out of lowering cost of production. This betokens rising real wages, and even steady or rising profits as rationalised improvements in the processes of production accompanied with increasing productivity primarily bring about this welcome feature. Mr. Peddie develops this self-same idea and argues for the so-called Dual System of stabilisation, *i.e.*, the producer controlling the output of money* and a regime of rising wages and falling prices. No new, though stimulating ideas altogether for advanced economic thinkers.

All this presupposes that the beau-ideal of the currency reformer, the modern Central Reserve Bank, exists solely for rediscounting purposes, that it does not compete with the commercial and other specialising banking institutions. Made to run for service rather than profits, the Central Reserve Bank can create, regulate and control the currency and credit system in the wider interests of the country. All expansion and contraction of the same depends purely on production and bills of exchange representing actual production. Such a Central Reserve Bank, a great many details of which

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* It is not wholly necessary for tho product to control the output of money. What is needed is that production and credit should run parallel to to each other and neither one should outstrip the other. *See* L. D. Edie — "Banks and Prosperity."

have been omitted, would produce the ideal monetary system as outlined above and a money market would appear as an indispensable accompaniment of its creation. Abnormal stock-market speculation* would indeed disturb this banking and monetary system, but these mental abberations ought not to side-track the efforts of monetary reformers who ought to make money and credit serve as a stimulator to greater industrial activity, employment, prosperity and welfare than they do at present.

Central Reserve Banking Policy.

What ought to be the monetary changes needed to realise this ideal cannot be raised just at present, but the correct policy to be pursued by the Central Reserve Bank in some of the most important controversial matters, as the following should be envisaged, *viz.*, satisfaction of the currency and credit requirements of agriculture, industry and commerce,

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* Exaggerated stock-market speculation has unfavourable effects upon domestic national economy. Differential profits and losses in a self-sufficient economy *ipso facto* do not signify an increase or decrease in goods. However, in the case of foreign speculators such profits and losses do involve real losses and gains of goods. Extension of credit to a highly speculative stock market reduces the supply of capital available for productive purposes, while a crash at best releases funds to the extent of what was previously borrowed and cannot increase the supply of capital above the original amount. Differential profits and losses to the extent that they are spent in consumption or refunded from incomes otherwise consumed, force readjustments of production which result in economic sacrifices. *See* the article entitled the "Theory of Stock Market Speculation" by Hans Richter Altschaffer, in the *Journal of Political Economy*, July, 1931, p. 237.

See also my article on Central Banks and Speculation." *Calcutta Review*, September 1932.

unemployment, trade cycles, speculation, gold movements and the world gold problem, International, central reserve banking co-operation, the stabilisation of the business activity, the satisfaction of the Government requirements and capital expenditure.

Let me take each plank of the banking policy of the C. R. Bank, *as it ought to be*. Modern Central Reserve Banking practice aims at making credit and currency available at low and steady rates to agriculture, commerce and industry by rediscounting the bills of exchange created in the three different departments of economic activity. The English banking system does not permit home industry to be benefited by low bank rates, for the overdraft facility of the Joint-Stock Banks can be secured only at "one per cent. above the bank rate, the minimum being five per cent." and as even this credit itself is anchored to dwindling gold stocks, the industrialists do not obtain the needed credit at a cheap rate while commerce and foreign importers get full benefit of low money rates arising out of low bank rates. The home industrialists are thereby placed at a disadvantage. This can be given up, only, when the C. R. Bank is wedded to the policy of creating enough credit based on notes, drafts, bills of exchange endorsed by a member bank and representing actual wealth production. The matter of commodity prices ought not to be the main criterion in bank credit expansion. If production were to control the creation of bank money, the above ideal would be secured.

Industrial Unemployment.

Industrial unemployment in our modern economic society is generally traced to the forced deflation or credit restriction policy of the banks, who are paying undue homage to the conventional limit of the cash reserve of 10 per cent., as is the case with the present-day Joint-Stock Banks of the United Kingdom. As soon as this limit is reached, even sound propositions have to be refused banking accommodation, as the banks have already lent as much as they can. The Central Reserve Bank, so long as it is anchored to the gold reserve, cannot hope to ameliorate the situation, for, even its power of creating credit is limited by its gold holdings, which the law fixes as an unalterable item—only not so unalterable as the Laws of the Medes and the Persians. But expansion at penalising rates is the result of present-day wise management of the C. R. Bank's note-issues. Though unemployment can arise out of several causes (*see* my Elementary Banking, p. 152), still the policy of creating credit on wealth products would enable the banks to go far in satisfying the credit needs of the *entrepreneurs*. If it is not gold and Government securities that ought to form the basis of credit structure the expansion of credit against wealth products would be possible. Producers even though they do not possess Government securities should have full facility to obtain the credit from the banking system. The closure of foreign markets and the general economic

disorganisation of the world would mean lesser effective foreign demand and Indian export trade cannot but suffer as a result of these external economic conditions or political influences over which the Central Reserve Bank cannot any hope to exert any control. But it is the duty of the banking system acting under the ægis and stimulating suggestions of the Central Reserve Banker to finance any extra activity in the direction of the normal export trade and the marketing of the crops.* This is a national duty and the responsibility of conducting this duty rests on the Central Reserve Bank.†

Trade Cycles.

The periodic trade booms or depressions which convulse the modern economic system arise as a result of natural causes or psychological expectations of businessmen or the monetary policy of the country. Although the initiating cause of the industrial fluctuations or the trade oscillations might be due to any one of the first two causes, these might be aggravated by the monetary policy of the banking system as a whole. At the acute stage the monetary

* The Canadian Banks are undertaking the financing of the wheat marketing plans of the pool although no external market has been found for the bumper wheat crop

† Seasonable unemployment in industry can be remedied by regularising production as many of the American manufacturing concerns have done. With more level sales a more steady production can be brought about. Steady production tends to steady and regularise employment. The banking system ought to help the business executives in this direction.

cause becomes fully perceptible and to this flaw is traced all the dire consequences befalling society. So long as the gold standard money is the prevailing feature, the wisest Central Reserve Bank cannot hope to remedy this feature. Insufficient gold reserve tends to bring about deflation and consequent fall in the prices of commodities. Thus the initial mistake lies in wedding credit to the gold basis lying in the bank's vaults. If instead of this rough and ready measure, the sane one of creating credit against bills of exchange representing wealth products is to be pursued, the inflation or deflation nor the inevitable boom and depression would not arise in almost rhythmic sequence. Wider understanding of general economic conditions, better industrial management and sound banking policies would go far in checking this, even in the present-day gold standard systems. But if industry is to run on an even keel, the producers ought to enjoy full facilities to secure the needed credit. Gold shortage ought not to hamper their legitimate activities. Production is not meant for securing gold, which after all is "a barbarous relic." Increased production, lowered costs, falling prices, rising real wages due to higher earnings, steady and slowly rising profits, shorter working hours, increased demand for labour, rising standard of life, expanding population and increased leisure, all these go together. These are the real economic data for increased "material well-being" and "national power." Even granted that such a society has been established at any time, still positions

of disequilibria will arise and it is the duty of the C. R. Bank to induce corresponding changes in society by virtue of its economic knowledge and credit-creating capacity to correct the positions of inequality and thereby swing round the pendulum of economic activity back to normal conditions. Wise Central Banking policy has no other aim than to modify the extremes which may tend to occur in an inflationary boom period or the prolonged trade slump and general or widespread unemployment.

SPECULATION.

Speculation is no mysterious and malign activity altogether, confronting the modern economic life of the world. The C. R. Bank's ability to solve this problem is very important. Fairly definite views were held in the past, that speculators grabbing after all for a fine margin of profit, can be deterred by low advances of the bank rate, which would tend to wipe out the margin. A growing control over speculative activity was considered part of the conscious process of bank management. Given prosperity, there is nothing in the world that can deter the speculators from carrying out their flights of imaginative hopes into actual reality. Under such conditions as were witnessed in the last American speculative craze, no weapon of bank control, either the brutal clumsy bludgeon of the bank rate or the subtler and more delicate rapier-like instrument, *viz.*, the open market operations, could bring the

evil to an end. Rationing credit, apart from the difficulty of carrying it out, intelligent banking co-operation with the C. R. Bank itself, the prohibition of foreign balances being lent for financing brokers' activities on the Stock Market and propaganda work have all failed. All this has arisen as bank credit is now being produced indiscriminately, if only evidences of gilt-edged investments are placed as collateral in the hands of the bankers. A new technique of creating money may ensure that legitimate productivity will not suffer at such times of marked and feverish activity, but the problem of eliminating speculation cannot altogether be thought of, so long as credit can be created out of the basis of securities. The present-day holders of Government securities have something like a quasi-monopoly in the creation of credit and though the modern banks have a voice in determining the quantity of credit to be created, the uses to which credit can be put are entirely out of their control. An attempt at controlling the quality of credit can and ought to be made by the C. R. Banks, for the speculators always commit mistakes. The Joint-Stock Banks and the members of the money market can indeed co-ordinate, collaborate and co-operate with the Central Reserve Bank in striving after this ideal. The Right Hon'ble Reginald McKenna voices this truth in a significant manner in his recently broadcasted speech quoted in the *Economist* of January 3rd, 1931: "On the plea that no Central Reserve Bank can control the uses of credit, it should not give up controlling the

quantity of money which has to be always made equal to trade requirements. In determining the utilisation and quality of credit the Bank of England can exercise considerable influence and probably more than the Federal Reserve Banks in the United States of America." The first and most obvious step in the direction of ameliorative measures must therefore be "an intelligent control in the qualitative as well as quantitative creation of credit."

International Gold Movements and the World Gold Problem.

International gold movements have many direct as well as indirect effects on the money market, the Foreign Exchange market and the Stock Market. Their influence on the rates of interest and supply of credit are of utmost importance to businessmen. Gold movements produce their effect on stock prices as well as the gilt-edged market. Broadly speaking, they tend to cause instability in economic life and unsettle the money market. International gold movements are now taking place more frequently as a result of commercial causes, such as the arbitrageur's profits, and monetary causes, such as the demand of the Central Banks, to augment their gold stocks. As I am not a gloating miser to feel peculiar pleasure at the sight of cheapened gold, I leave aside the commercial causes for gold movements out of consideration. Monetary causes tend to bring about the movements of gold from country to country.

The indebted country parts with gold and restricts credit and induces fall in prices. This leads to commodity exports and a return flow of the lost gold is initiated, other things being the same. If this natural flow is impeded and gold tends to be inequitably distributed contrary to the sound dictum laid down by Recardo in his famous " Law of the Territorial Distribution of the Precious metals " an inefficient use of gold is brought about in the gold hoarding country. Witness America and France, who are sterilising a large quantity of gold and are threatening the world with the consequences of drastic fall in commodity prices, which would ultimately end in shrinking production and lowering the consumer's purchasing power. America is well off, as it has established a dollar standard and has tacitly acknowledged the failure of the automatic unregulated gold standard monetary practice.* Credit is being created by rediscounting bills of exchange and at any rate it is better off than other countries which do not follow modern central reserve banking practice.

Recognising that the modern gold standard is a failure and would be more so in the near future as a result of the shortage of gold and mal-distribution of the existing stocks, true wisdom consists in adopting the policy of basing credit not on gold alone but on bills of exchange representing wealth

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* *See* my article on "India and the future of the gold standard". The *Ganga*—the Punjab Journal of Economics and Commerce—January 1932.

products. Modern international trade is ultimately speaking a refined form of barter. The understanding of each other's wants and securing them without the intervention of money would be a better solution.* So long as this ideal of the banking system cannot be secured, it is incumbent on the Central Reserve Banks to prevent abnormal gold movements and leave the normal gold movements to work out their effects in course of time. The repatriation of a permanent surplus is its main duty.

International Central Banking Co-operation.

Initiated by the Right Honourable Montagu Norman and the late Mr. Benjamin Strong, international Central Banking Co-operation has become a settled feature in the modern days when economic problems are becoming international in scope. The settlement of German reparations and the international indebtedness items of the Allies to America have become keen problems of worldwide importance. To solve such vital problems, an international financial League of Nations is being set up.†

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* Surplus Canadian wheat could be supplied with advantage to Brazil in return for her surplus coffee production. A similar deal was entered into between the U. S. A. and Brazil. A wide resort to it is now being made by the Central European countries (May 1932).

† The International Bank of Settlements has become a settled fact and it is too early to say whether the international aspects of its operations would be beneficial or not. *See* Paul Einzig—" International Bank of Settlements," pp. 114-118.

See also my *Elementary Banking*—2nd Edition in the press—chap. on Bank of International Settlements.

Possessing gold stocks to a large extent, India can effectively lend a helping hand towards the solution of the gold shortage problem, which is now a world issue.* The initiation of gold cash certificates repayable in gold or legal tender money would tend to mobilise some of the stocks. Large stocks of gold are now held by the Banks against which loans have been made. The securing of hidden or hoarded gold at particular places and impounding it in the Central Reserve Bank would tend to augment the stocks. Such a provision exists in the 1925 Gold Standard Act of England. All gold above £10,000 or not meant for legitimate export or industrial purposes can be confiscated by paying a particular price and impounded in the vaults of the Bank of England. The payment of customs duties, *i.e.*, import duties in gold, can be insisted on, as has been done in China in 1921. This would redistribute the gold holdings of the countries. India need not fear any shortage of gold for the Central Reserve Bank even if it were to be started on the present-day gold bullion standard system involving the keeping of 40 per cent. ratio of gold reserve to total notes and deposits. The immediate securing of gold can be done through the mediation of the League of Nations and subscriptions to the gold loan by the different countries would enable us to start the Central Reserve Bank. The gold produced inside

* *See* my article on "Exodus of Gold" Mysore Economic Journa April 1932.

the country can be retained.* The large favourable balance of trade can be taken advantage of and by buying the export bills gold can be ordered out of the proceeds of such bills. A consistent pursuit of these above measures and such other measures which were undertaken by Russia† would not only bring us the much needed gold to repay the gold loan, but have a substantial gold holding. A slow and gradual liquidation of the British securities held in the reserves beyond a handy particular reserve would undoubtedly augment the gold holdings. But our Central Reserve Bank should respect the Washington agreement of 1927, as regards the non-interference of the Central Banks with each other's gold reserves by means of discouraging direct purchases.

Stabilisation of Business Activity.

Steady and slowly increasing business activity, accompanied with rising wages and slowly falling prices, conduces towards better prosperity than "stable purchasing power" alone. Stable purchasing power means changes in individual prices of commodities. Certain commodities may be dearer in one country than in another. World stability can

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* *See* Dr. Fremor's Estimate of Gold Production in India up to the end of 1940.—p. 51 of the Interim Report of the Gold Delegation of the Financial Committee.

† *See* Mr. Rothschild's Evidence before the Fowler Committee-Report—Minutes of Evidence—Q—7613.

be obtained if each nation attempts to study each other's wants, and so balance and exchange their respectable surpluses. World prosperity can be advanced only by promoting the sub-division of labour so that exportable surpluses can be created which are largely desired by other countries. The C. R. Bank's duty would be to guide and aid business activity in such a manner as to secure the highest amount of business welfare. The key to business stability lies in the hands of the C. R. Bank.

The above measures would tend to make the C. R. Bank act as the vitalisor of the banking system, as the constructive guide and national leader leading to economic prosperity, banking safety and the solidity of the national credit structure. The compilation of varied economic data and the statistical situation of the Joint Stock Banks, once on the 21st of each month, and the publishing of the same in monthly reports or bulletins would lead to the evolution of sound plans of finance and production. It would give us a suitable financial machinery to facilitate the collection and disbursing of the Government's revenue, here as well as in England, though it might not hope to dispense with all the sub-treasuries and treasuries of the Government. The management of the sterling debt and the slow repatriation of the London enfaced rupee paper under its intelligent guidance to the Indian investors and the floatation of new sterling loans, if needed, to finance our capital expenditure, the cheapening of

the means of internal remittance, the removing of the present-day unfavourable rates of exchange for domestic exchange and the reducing of unreasonably high rates of interest in the interior can be achieved only as a result of perfecting the money market, increasing the specialising agencies, empowering these to tap the pooled resources in the hands of the C. R. Bank and inviting their cordial support and help in conducting the banking and monetary structure of this country.

Impossible Dream.

This modern academic dream can be realised only in an Economic Utopia and, certainly not, on this mundane earth. A highly integrated and disciplined banking system cannot be evolved all of a sudden. Any significant changes in banking framework cannot be made at a time when the attention of the people is preoccupied solely with political re-adjustments. A solution of all the present-day banking evils is beyond the ken of any single individual thinker. But a rough outline of the future position, which the present-day banking units ought to occupy in the reconstructed banking theatre, will be placed before the reader. Within the small compass of a single lecture it would be impossible to elaborate my precise views exhaustively. So I would confine myself to the mere offering of few remarks in elucidation of my important suggestions.

First and foremost, there ought to be two registers, one for banks and bankers and the other for the money-lenders, pure and simple. The general public ought to know who the real bankers are and the banks themselves ought to know what privileges are conferred on them and what their proper duties are. Finally, they ought to know who their customers are and their duties and responsibilities to them. (*Vide* Appendix IV).

The registered money-lenders should similarly be differentiated from the casual and the itinerant money-lenders.* Anyone conducting money-lending as a regular ancillary operation should be registered as a money-lender. Conducting banking, along with other operations, they have been occupying a useful rôle in Indian economic life, rural or urban. Their utility has to be heightened, their imperfections have to be remedied and they must be made to discharge their professional duties as well as

* It is a pity to find that most of the Provincial Banking Enquiry Committees, like the Bombay and the U. P., fight shy of the problem of licensing money-lenders on the lines of the British Money-lenders' Act of 1927, though it has been recommended by the Royal Commission on Agriculture (para 366). The Punjab Regulation of Accounts Act, 1930, is indeed an improvement on the situation. The licensing of professional money-lenders is not the only remedy. The Uniform Small Loans Act, which is in force in 25 States of the U.S.A., provides that licensed lenders operating under State supervision may loan in amounts of not more than Dollars 300. The maximum interest rate is three and half per cent. monthly on unpaid balances and may not be compounded. No deductions or commissions are allowed. Loans may be repaid at any time. Lenders are required to keep uniform records which are at all times subject to inspection by State officials. *See* Biddles and Bates,—" Investment Banking," p. 478.

responsibilities. They must be helped by the State in the matter of collecting their loans and access must be given to them to tap the Central Reservoir to increase their financial resources. Subject to professional or Government audit and giving more publicity to their operations and improving their business transactions with their illiterate customers, their mission can be ennobled in every way. It is quite possible to harness them to bill-broking or investment banking or accepting business or any other kind of specialising task which a well-developed money market would require. The State has to evoke their patriotism by conferring titles, etc., and it would find these grabbing money-lenders, heartless usurers and cruel parasites changed into heroes and idealists and the transformation of social organisation is only possible by such individual regeneration on their part.

The indigenous banking houses and shroffs, as I pointed out long ago, should be developed into modern bankers and "banking institutions" as has been done by the Hon'ble Raja Sir Annamalai Chettiar's firm which has developed into the "Bank of Chettinad, Ltd.," with a ramified branch banking organisation extending over Burma, South India and Ceylon. Aiming at the advantages of Joint Stock form of enterprise, it seeks to systematise and modernise indigenous banking and inspire greater confidence in the minds of its clientele by giving publicity to the properly audited statistics of its

modernised banking operations. The indigenous bankers who refuse to consider this can select specialisation in bill-broking or take up the duties of the exchange broker more actively. The partnership indigenous banking firms and the city shroffs can be easily developed into acceptance houses or discount companies securing proper contact with the Joint-Stock Banks and the money markets. The moffusil shroff can safely act as the agent of the Reserve Bank and the financing of agriculture can be safely done through his well-known channels. The credit control policy of the Reserve Bank can be made effiective through him.

Co-operative banking occupies an important place in the provincial financial and banking system. But it must be made more effective and co-operative credit has to be cheapened. Specialisation in the two-fold branches of long-term and short-term credit has to be introduced. The popularising of co-operative paper and the borrowing on good co-operative paper instead of depending on overdrafts would enable them to secure cheaply additional resources and establish the needed contact between the Joint-Stock Banks and the Co-operative banking institutions. The quick dispensing with the loan applications, the checking of overdues and other irregularities in strict business-like manner, the utilising of the cash credit system by means of which primary societies can tap the funds of the Co-operative Central Banks, the instilling into the minds of the

borrowers the fundamental principles in the art of living and above all running the co-operative banks in a strict business-like manner would enable us to create credit on sound lines both for the short-term, intermediate and long-term needs of agriculture. (*Vide* my article on the Extension of the Co-operative Movement—*Indian Insurance and Finance Review*—Appendix V.)

The creation of other specialising institutions would enable us to change the centuries-old habits of the people in the matter of their investment tendencies. There is no greater need at present in India than the one of increasing the savings habit of the people and the encouragement of their investment in the wider economic interests of the country.

The Joint-Stock Banks themselves have to perform signal service in this direction. Nothing is more fundamental than the one of enlarging their agency services, which ought to be gratuitously performed, if possible, for their customers in most cases. Some of them are showing commendable zeal in undertaking the Home Savings safe deposit business and inculcating the investment habit in the minds of the small savers. (*See* Appendix VI).

The smaller banking institutions, be they the loan companies of Bengal or the Nidhis of Madras, can be made to play a more useful part. They can concern themselves particularly with the promotion of industrial enterprises, the underwriting or guaranteeing the sale of stock or bond issues and the selling

and distributing of securities. Some of them might act as mere savings agencies accepting deposits from individuals and then invest them on their own account. From the return of these investments, which ought to be carefully safeguarded by State regulation, interest can be paid to the depositors or credited to their accounts and the bank would meet its expenses and earn a profit. The most important kinds of banks acting as the chief source of short-term credit in the Indian banking system should be (1) the registered money-lenders, (2) the registered indigenous bankers, (3) the investment banks (some of the loan companies and Nidhis can be converted into these, (4) the savings banks (the smaller banks can be converted into this type, (5) the Joint Stock Banks, (6) the Immigrant Exchange Banks, (7) the Co-operative Banks conducting ordinary banking as well, (8) the Insurance Companies which can lend very nearly to the surrender value of their policies. The desirability of completely co-ordinating their services need not be emphasised strongly. It is then alone that we can expect to supply all our short-term monetary requirements without the aid of external capital.

The Post Office Savings Bank ought to extend its field of action and deserve fully the appellation that they are the "poor man's banks." The issuing

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* It is a matter of gratification to record that the Hubback Committe on co-operative credit movement have recommended the self-same suggestions for toning the c.c. movement in Bihar & Orissa.

of the "Stridhan gold certificates," as recommended by the Bihar Provincial Banking Enquiry Committee would go a long way in changing the present-day habit of investment which consists solely in locking up savings in gold jewellery.

A well-balanced banking system cannot be secured unless the Exchange Banks are performing some services which bind them more closely with the other banking units. The Foreign Exchange Banks have to be changed completely in capital structure, organisation and service. The Indianisation of their stock, a real change of heart and popular service to all, should be their motive. (*See* Appendix VI).

A closely-knit money market, where a perfect mobility of funds exists, would be unattainable without this collaboration, co-ordination and co-operation of the different banking units with each other and with the Central Reserve banking institution. A clearing house, which collects as well clears in a cheap expeditious manner, would greatly reduce the requirements for cash and much of the business of the country, even between distant points, should be transacted without any actual movement of money whatever.

One fundamental feature of banking reconstruction should aim at diverting the surplus home or domestic funds for the financing of foreign trade and *vice versa*, *i.e.*, surplus foreign funds for financing home trade and industries.

The future business of the Imperial Bank may be extraordinarily wide or restricted. It would carry on banking business, acquire deposits, make advances, discount bills, issue drafts, deal in exchanges, specie and precious metals. It would be empowered to borrow money and do anything incidental to any of its powers. It ought to continue the opening of branches. It would compete more vigorously than at present with the Joint Stock Banks and the Exchange Banks. If it were to continue holding Government deposits, though to a lesser extent than before, it would have to maintain a very liquid position and this alone will enable it to maintain the financial prestige, which it has built up out of a long and honourable record of service. It is quite fit to conduct exchange banking or industrial banking (witness the suggestions to grant long-term loan to bring about the cotton merger) involving a large turnover of funds into lock-up advances. But the exigencies of the situation demand its continuance as a *true* commercial bank—as a bank of deposit, discount and exchange. Its Savings Bank department should continue. It can maintain a separate Industrial Credits department, where long-term loans can be given to co-operative banks on the basis of co-operative paper, to industries and other banks and any additional money needed for this purpose can be secured by floating debentures. This must be definitely understood as non-commercial business and not allowed to directly clash with its commercial business. Thus envisaged its future

seems to be that of a big commercial bank combining within itself miscellaneous functions of all sorts which would be kept entirely apart from the pure functions of a trade bank. (*See* Appendix VII).

By helpful legislation, the State has to facilitate the wider use of credit instruments, fasten greater responsibilities on the bank directors and superior executives and enable banks to conduct perfectly honest and straightforward business by providing adequate reserve funds, insisting on proper minimum paid-up capital and proper cash reserves, lending on good collateral liquid paper or on unquestionable personal credit of an unimpeachable character and compelling banks to adopt proper audit principles. The raising of short-term loans on the strength of mortgage has been the baneful feature of the Indian monetary world. This has to be rectified. Licensed warehouses, produce loans and orderly marketing are the means for enlarging the basis of the credit system and facilitating the short-term loan business. This would render unnecessary the buying of *hundies* from the indigenous bankers at high rates of interest or borrowing from the Imperial Bank on a pronote which requires double signature. The widespread use of credit instruments is the only safe method of raising short-term credits. These, by rediscounting, would make the mobility of funds, a settled feature.

* The new contract has rightly insisted on the Imperial Bank's maintenance of the existing branches which number 170 in all.

Modern Central Reserve Banking practice is the panacea for the inelasticity of the present-day financial machinery and the high rates of interest ruling everywhere in the country and which are tending to handicap our economic progress in all directions. Discounting ought to supplant short-term borrowing. The financing of the short-term needs of the agricultural and industrial producers must be brought into the orbit of the discounting system as has been done in the U. S. A. banking system, through the co-operative credit societies to whom crops should be hypothecated and produce kept in the licensed warehouses or godowns, *viz.*, facilities provided by the co-operative banks or co-operative loan and sale societies.

An All-India Banking Association and one for each province would be a distinct improvement. It should consist of representatives of all banks, representatives of the money-lenders, the co-operative banks, the indigenous bankers, the Post Office and the Finance Member, representatives of agriculture, industry and commerce. The duty of preparing the registers mentioned already should be its first task. It should be the organised active body on all matters of banking and can be safely empowered to transact such duties as the Canadian Bankers' Association has been conducting in that country. The teaching of banking, including co-operative banking, and the provision of specialised training in advanced banking should be done under its auspices or it should

co-operate with the Commerce and Economics faculties of the University. The collection of accurate information and banking statistics of the financing agencies and the publishing of the same would enable it to represent the economic efforts of the province. It should co-operate with the Provincial Boards of Economic Enquiry which would very soon be started on the lines of the Punjab model. It should endeavour to carry on intensive propaganda for the growth of co-operative banking. It should study and foster all forms of specialised banking. Comparative banking statistics are highly essential and it should be the duty of the Association to bring about this feature. Auditors selected from the official list, who would be auditing the banking offices, would do well to report all irregularities to this Association, which has to see that the banks conduct their operations on prudent lines.

The recognition of equitable mortgage in the chief important cities other than the Presidency Towns, the making of the railway receipts, a safe bankable security, the more speedy settlement of commercial suits in the moffusil civil courts, the more careful administration of the Insolvency Act with the object of securing quicker and more prompt decision and more effective execution by the official receivers and assignees and the provision for the registration of title to land are some of the useful legislative measures which the State has to recognise as conducive towards sound and successful

banking. Steps have to be taken to facilitate the making of loans on immovable property belonging to the joint family, be it Hindu or Mahomedan.

Conclusion.

The one distinct lesson which a keen observer of Economic History would disclose is the integration, collective endeavour and the co-ordination movement in all fields of economic activity. Neither vested interests nor mere blind customary habits should stand in the way of wider unity. The development of *espirit de corps*, improvements in the technique of administration of the smaller banking institutions, the rationalising of the banking methods of the indigenous bankers and the application of willing and effective co-operative methods to the more advanced problems of our money market organisation would prepare the way for the banking millennium. Even if it were not to bring about this laudable desire, it would tend to create a compact money market with homogeneous institutions which would remove one of the main present-day troubles, *i.e.*, the great disparity between the bank rate and the market rate in the important money markets.

LIST OF BOOKS WHICH CAN BE READ WITH PROFIT AND INTEREST.

1. B. R. RAU—"Elementary Banking."
2. F. WHITMORE—"The Money Machine."
3. SIR J. C. COYAJEE—"Sir William Meyor Lectures on Indian Currency System", 1930.
4. B. R. RAU—"Present-day Banking in India," 1930.
5. W. F. BURGESS—"The Reserve Banks and the Money Market."
6. C. H. KISCH AND ELKIN—"The Central Banks."
7. ANNUAL REPORTS OF THE CONTROLLER OF CURRENCY—1927-28, 1928-29, 1929-30, 1930-31.
8. REPORTS OF THE DIFFERENT PROVINCIAL BANKING ENQUIRY COMMITTEES AND THE CENTRAL BANKING ENQUIRY COMMITTEE REPORT.
9. H. F. R. MILLER—"Foreign Exchange Market."
10. T. E. GREGORY—"Foreign Exchange."
11. H. C. WALTER—"Modern Foreign Exchange."
12. MONEY MARKET REVIEWS—"Indian Finance" or the "Statesman."
13. CENTRAL BANKING ENQUIRY COMMITTEE REPORT.
14. HARTLEY WITHERS—"The Quicksands of the City."
15. MACMILLAN COMMITTEE REPORT-CMD—3897, 1931.
16. J. M. KEYNES—"Treatise on Money."—2 Vols.

17. EXTERNAL CAPITAL COMMITTEE'S REPORT.
18. E. M. HARLEY—" Safety of Capital".
19. H. W. GREENGRASS—" The Discount Market in London."
20. W. COLLIN BROOKS—" How the Stock Market really works".
21. W. COLLIN BROOKS—" Theory and Practice of Finance."
22. SIR JOSHIAH STAMP—" Gold and the Price Level."
23. J. V. KAVANAUGH—" Bank Credit Methods and Practice."
24. PARK MATHEWSON—" Acceptances Bankers and Trade."
25. LAWRENCE AND TAYLOR—"The Capital MARKET".

APPENDIX I

THE REMONETISATION OF SILVER*

Propounded by the great banker Mr. J. F. Darling, this idea of restoring silver as the metallic standard in the Eastern countries, *viz.*, China, India, Sudan and Arabia, is becoming a fashionable recipe for solving the present-day world-wide trade drepression.[1] If the Eastern agricultural masses were to regain their purchasing power, which they would by the selecting of silver as their standard monetary metal and thus increase the value of their silver hoards, the Western manufacturing nations would find a market for their products. Mutual prosperity would result out of this step. Thus viewed, this proposal is merely a repetition of what happened in the United States of America immediately after the Civil War. To prevent the commodity prices from falling lower, silver dollars were added to the circulation as a result of the persistent agitation on the part of the silver interests. Currency history is only tending to repeat itself.

Secondly, the present-day distribution of the world's gold is faulty. The United States of America and France[2] are possessing the bulk of the world's gold stock. They are

* This was originally published in the "Indian Finance" and in the "Indian Journal of Economics", July, 1931.

[1] *See* Lord Brabourne's Speech, Annual Meeting of the Consolidated Gold Fields of South Africa, reported in the *Statesman*, 29th December, 1930.

See also Senator Pittman's Speech at Washington of 25th November, 1930, quoted in the *Liberty*, 21st December, 1930.

[2] France receives gold as a result of the fact that she receives far more from the reparations payment than what she pays to foreign countries. This theory accounts satisfactorily for the increase in gold as well as steady short-term foreign balances which are not converted into long-term capital investments and are being used in short-term money markets. These are tending to act as a drag on the stability of the international monetary situation. *See* the *Statist*, September 6th, 1930.

fast becoming a bottomless sink of the precious metal—gold. Though the inward flow of gold back from America into the European monetary systems becomes discernible since 1927-1928, this movement is not a very perceptible one and the ideal distribution of gold which ought to follow the well-known law of the Territorial Distribution of Precious metals is becoming impossible under such conditions. The credit system of the different countries of the world cannot therefore be based on gold, which is becoming rarer as a result of the diminished output of gold from the mines and its being locked up or selfishly impounded in the banking systems of these two countries. Sound international credit conditions cannot ensue as a result of these twin problems concerning the world's gold stock.[3] If international bimetallism were to be adopted, world-wide credit disturbances need not be apprehended.

Nextly, the token silver coins which are used extensively in Great Britain, France and the Continental[4] countries in the pre-war days have been given up. Becoming habituated to paper substitutes during the war-time they have given up the minting of silver as a subsidiary metal in their present-day composite monetary standard. Unless this practice is also revived and the monetary demand added to the pure industrial demand for silver, the value of silver would not rise to a substantial level—profitable enough to continue silver production on a large scale.[5]

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[3] *See* Sir Henry Strakosch, the London *Economist* Special Memorandum, dated 5th July, 1930, entitled "Gold and the Price-Level."

See also the Interim Report of the Financial Committee of the League of Nations, enquiring into the problem of "Gold and the Prices."

[4] About 66,000,000 oz. of silver coins were demonetised by France and Belgium. *See* Senator Pittman's Speech.

[5] At one time the price of one oz. of silver was about 125 cents and it has now dropped to 33 cents per oz. In order to make it remunerative the suggestion of Lord Brabourne is to raise the price of silver to 2s. an oz.

The dumping of silver by the different governments is responsible for the unduly low price of silver or the phenomenon of lower prices in spite of diminishing output of silver. The silver interests of the United States of America, who are still a power in politics, are already vigorously protesting against this unwarranted interference with the price of silver. It is indeed curious that the suggestion of selling silver by means of open tender has not been adopted although about 46,000,000 oz. of Indian silver were sold by the Government of India. This low price of silver is considered to be the main cause of lowered trade with China and the East. It is, however, forgotten that even the Western countries lack the real purchasing power, as the incubus of the war debts weighs heavily on them.[6]

Academically speaking the proposal is based on sound reasoning. But the present-day world is tired of novel monetary plans. Conscious of the fact that no commodity standard, be it gold or silver, can give us an unvarying price-level, people have been looking to banking policies as their saviour in this particular direction. International Central banking co-operation would become impossible if the world is divided into the East and the West, the former using gold, the latter using silver as their standard monetary metals. The complications, to which foreign commerce between the two groups possessing independent currencies would be subjected, would be important obstacles of no mean character. Besides these difficulties it would not constitute a permanent currency reform.

It is not by this monetary remedy alone that the present-day world-wide trade depression can be solved. A revivification of the purchasing power would stimulate effective demand,

[6] *See* Mr. Goodenough's scheme for the International Settlement of War Debts. The United States of America sends a full third of its exports to Europe and this lack of purchasing power is no less responsible for trade depression in the U.S.A. than the lack of ability on the part of the Eastern countries to consume American goods.

but there is a remarkable lag between the fall in agricultural prices and the fall in the prices of manufactured commodities[7]. While bountiful nature tended to reduce the prices of agricultural commodities in almost all the countries as a result of the surfeit of these good things, the labour organisations of the wide-awake economic systems have refused to be content with lowered wages.[8] As no assault on the earnings of the wage-earners has taken place, no pronounced reduction in the cost of production of manufactured products has resulted. Unless attention is drawn towards improvements in this direction, the mere increasing of the purchasing power is no solution. The elasticity of business and industrial factors[9] is totally lacking, with the result that there is no proper adjustment to the low level of the commodity prices brought about by lesser purchasing power and previous over-buying of the manufactured articles, which were sold with ease in the past few years. The consumers are "suffering from a severe attack of indigestion" and unless this demand is exercised once again the industrial depression will not pass.[10] While the world population has increased slowly, the output of prime commodities and manufactured commodities has

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[7] The prices of raw materials and foodstuffs have fallen by about 30 per cent. while that of manufactured exports by 20 per cent., the cost of living by 11 per cent. and the money wage by less than two per cent.—*See* the Report of the Business Conditions in the United Kingdom, October 20, 1930, Memorandum No. 25 of the Royal Economic Society, p. 3. The case is not different with the other important countries of the world. *See* the *Statist*, September. 6th, 1930, Article entitled "Trade and World Harvests."

[8] Look at the recent German Strike in the Berlin Metal Industry as a result of the refusal of the Trade Union to accept the official arbitrator's award. *See* the *Statist*, October 25th, 1930, p. 568.

[9] There is no attempt to revise wage-scales downwards nor lower the *gap* between the wholesale and retail prices. These factors are responsible for the economic sickness which has been affecting most of the countries of the world.

[10] *See* the Business Letter of the Canadian Economic Service, McMaster University, Hamilton, Ontario, October 10th, 1930.

increased greatly bringing about this inevitable slump and business depression.

The tariff nuisance is no less a menace and the free movement of commodities is being hampered in all countries despite the pious and ineffective resolutions of the World Economic Conference convened in Geneva by the League of Nations in 1927. The Smoot-Hawley Tariff precludes the other countries from purchasing the cheap and versatile American goods. It is only just recently that tariff truce negotiations have been completed to facilitate mutual trading relations between Belgium, Luxemberg, Denmark, the Netherlands, Norway and Sweden.[11] These protective tariffs generally make it impossible for foreign countries to find markets for their exports. It is now becoming apparent that world prosperity cannot be built under such conditions.

World-wide economic stability cannot be secured by this single monetary reform—the resuscitation of silver as a monetary metal in the East. In so far as it concentrates our attention on the concurrent gold output and distribution problems it does some indirect service. But unless all the countries adopt the same monetary gauge, *i.e.*, gold, as a standard metal, there would be no unifying element and exchange operations would be rendered difficult by this reform. Mischievous consequences fraught with great danger might arise. Changes in the market price of silver would add to the risks of foreign commerce. It would degenerate to mere gambling ; as the moving parity might cause at one time excessive activity in the home trade and excessive activity in the foreign trade at other times. These fluctuations would be erratic and cannot be anticipated by any rational processes of reasoning. Hence international trade would be greatly hindered. It is for this reason, that though silver is used for internal

[11] See the *Statesman*, Letter of the Oslo Correspondent, published on December 24th, 1930.

purposes, gold is selected for external payment purposes by the silver using countries.

Again there is a faulty assumption that silver production would be on the increase to such an extent as to satisfy the proposed increased monetary demand. It is the opinion of experts that new silver from the mines of Australia and the United States of America would dwindle and that the supply of silver would fall off in the near future unless it is to be counterbalanced largely by increased output from the Mexican mines, which have so far been only partially exploited.[12] During the recent war-times and the disturbed political conditions ensuing in Mexico, the silver mines became an uncertain factor, with the result that the price of silver rose to an unprecedented height. It caused grave danger to the Indian monetary system which could only be solved by the timely action of the United States of America in passing the famous Pittman's Act to satisfy our demand for silver to the extent of 350 million dollars. Will not similar conditions ensue if India and the Eastern countries were once again to mint silver furiously to satisfy monetary demand?

Silver apparently has no monetary future. Silver rupees are fast returning to the Government Treasuries in various parts of several of our provinces. This tendency shows unmistakably that our people dislike the silver rupee as pocket money.[13] Only in the remote interior does the silver rupee hold its fascination on the rural masses. In almost all the bigger centres and trading marts, the merchants and business-men are making an increasing use of the Goverment facilities

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[12] The production of silver as a by-product of lead and other mines has also to be reckoned in these calculations. Improvements in mining may also tend to increase the output of silver from the mines. But the production of silver was materially reduced in each month of 1930 bringing about, unfortunately, no increase in the price of silver.

[13] *See* the Annual Report of the Controller of Currency, 1928-1929. The average active circulation of notes has increased by nine crores during this year.

for remittance provided through treasuries and currency offices.

Even in Iraq, the Arab is now holding gold and the proposed new currency (December 1930) as in the case of Palestine is more or less a gold-exchange standard with internal currency based on sterling. The Turkish Gold Lira has already risen by one rupee as the Arab is buying up gold.[14]

It is not only in the East that the popularity of silver as a form of money is waning. When the Federal Government of the United States of America attempted to coin silver into 271 million dollars in 1921 and force them into the circulation, the people did not respond nor show any genuine preference for them.[15] It is attempting to eliminate the silver dollar and certificate from the monetary system altogether and keep it as purely subsidiary metal for small change and circulation purposes. General demonetisation and falling prices are inevitable so far as silver is considered for both in France and Germany bank notes of smaller size are being increasingly used in place of specie.[16] The old irredeemable five-franc silver pieces are no longer the monetary standard in France. This old limping standard has given way to the new gold franc and the gold bullion standard system has been adopted in 1928. Thus there is a continual demonetisation of silver all over the world. The silver standard is fast becoming a barbarous relic. The economic disaster, such as the present

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[14] Quoted from the *Statesman* Bagdad Correspondent's letter, dated December 11, 1930, published on December 24, 1930.

[15] *See* G. W. Dowrie's American Banking and Monetary Policies, p. 300. It could not but be so, for, from 1928 the monetary policy was to substitute small Federal Reserve notes for the silver certificates in one and two-dollar denominations. The attempt is to completely retire silver dollars and silver certificates from monetary circulation.

[16] *See* the Interim Report of the League of Nations on "Gold and Level of Prices." It recommends that the extended use of cheques and smaller bank notes should be given up and in their place subsidiary coins should be used or else the demand for gold as the basis of credit would not be lessened.

world-wide industrial trade slump might have been aggravated by the narrowing of the basis of credit, but it is not the sole cause and although "cheap and easy" money is being intentionally maintained by the banking policies of some of the advanced countries yet there is no immediate recovery even in these countries pursuing this policy.

The adoption of silver monometallism by the Eastern countries would make them flounder considerably before they can perfect their banking and monetary policies. There is a distinct trend all over the world to give up the metallic currency, be it gold or silver, even though the gold standard in one or other of its varied forms is being adopted. The use of paper as internal currency is on the increase. This is the case in almost all the Eastern countries except in China, which begins to hoard silver as soon as political conditions destroy the confidence of the masses in the note-issues. It would be a retrograde measure if these Eastern countries were to give up this useful habit as a result of this suggestion and accept silver monometallism with silver coins in circulation as the accepted feature of their monetary organisation.

One of the best solutions of the world-wide trade depression is to forcibly lower the long-term market rates of interest to the old pre-war level. Prof. Keynes rightly points out that "to the Economic historian of the future the slump of 1930 may present itself as the death struggle of the post-war rates of interest and the re-emergence of the pre-war rates."[17] The market rate of interest is no doubt falling but not fast enough to catch up the natural rate of interest. Hence there is recurrent profit deflation leading to recurrent income deflation and a sagging price-level. So the banking systems should influence the market rates of interest and induce the belief that low short-term rates of interest would tend to prevail for a long time. This can be done by lowering

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[17] *See* J. M. Keynes, Treastise on Money, Vol. II, p. 384.

the deposit rate of interest in both countries, *viz*., Great Britain and the United States of America, to half per cent. International Central Banking Co-operation should have as its main plank of reform the maintenance of low short-term market rates of interest by means of bank rate policy and the open market operations. It is by these methods the rate of investment has to be controlled and through it the level of prices. Any other mistaken policy is bound to sap "the very foundations of capitalist society," says Prof. Keynes, who has unfortunately been playing the rôle of Cassandra for the last eleven years. But the political uncertainties create an air of tension and the psychological confidence required on the part of the capitalists to make long-term investments is not forthcoming. Hence it is likely that capital resources will be allowed to lie idle in the short-term money markets. Thus this banking policy also is bound to be sterile so long as this confidence is not generated.[18]

For the various reasons cited already it is impolitic to give up the wise policy enunciated by the Hilton-Young Commission. An international agreement to use silver for monetary purposes on the part of the different countries would be a backward step. All that can be done to pacify the silver interests is to arrange for a more judicious way of disposing off the unwanted silver by the respective Governments by means of making them accept the open tender system for the sale of silver, so that the industrial requirements might be satisfied in this manner. This would prevent silver touching rock-bottom prices in the near future.

India, once, had the opportunity to give up the silver standard and return to the gold standard during the recent

[18] The Federal Reserve Banking system is steadily pursuing the policy of creating "easy money" conditions during the first and second half of 1930. The recent report issued by the Harvard Economic Society shows that the stage has been set already for a financial recovery but the needed internal adjustments in business have not been taking place and there is no recovery of trade and industry even in the United States of America. *See* the Memoranda of the Royal Economic Society, Nos. 22 and 25.

war-time. It was sadly neglected and as a result of the flooding of the market with silver the present-day misfortunes are being experienced. We cannot hope to extricate ourselves out of this impasse by following a policy of wait and see or by accepting the proposal for the remonetisation of silver.

Even granted that an international agreement for the increased use of silver as monetary metal is brought about and the vested interests of the United States of America were to succeed in raising the price to such a level as to wipe off the difference between the nominal and bullion value of the coin, the Government of India can safely issue the one-rupee notes as a valuable expedient to tide over such contingency. Any further increase in the use of silver for our internal currency purposes would be postponing for ever the sound currency plan adopted by the Hilton-Young Commission and partially carried out by the Government of India.

APPENDIX I. (A)

THE STABILISATION OF SILVER—PART I. *

MAIN REASON FOR THIS SUGGESTION.

Almost despairing of the possibility of stabilising the long-period value of gold[1] and finding, it increasingly impossible to bring about an equitable distribution of world's existing gold stock[2] drastic and radically novel proposals[3] are being suggested by economists, laymen, and the vested silver interests to artificially raise the value of silver by sheer *force*

* Paper published in the Indian Journal of Economics—July 1932.—

1 No serious attempt has been made thus far to grapple with this problem at least on the lines recommended by the Genoa Financial Conference of 1922, nor have the recommendations of the League of Nations Gold Delegation Committee been carried out by the different gold-using countries. The recent suspension of the gold standard by the United Kingdom on September 21st 1931 followed by other countries has made the possibility of making gold an international standard a very remote contingency. Sterling is pitted against gold and the attempt of the British Currency experts is to provide a solid proof of the stability of the pound sterling as against the gold. But a time will come when it will have to be attached to a standard. Perhaps the moral triumph of the "tabular standard" which is so ardently preached by every Marshillian is about to become an accepted fact. It is quite likely that "the laissez-faire hard shell gold bugs" will not succeed for there is a determined attempt being made by the Empire Economic Union to have a big Empire Central Bank of its own and settle the Dominion Exchange problems with its help.

(2). Both America and France refuse to play the game of the International Gold Standard. As creditor countries they refuse to lend long and they do not allow their gold to upset or even influence their price-level. Gold is sterilised or bottled up with the effect that the American or the French price-level does not rise and bring about an international current of the inflow of goods. Gold must be lent to the countries of the world cheaply, easily, and freely to secure currency stability in these borrowing countries. The Federal Reserve Board is now raising the Bank rate to check the outflow of gold from the American Banking system on the plea that its free stock of gold as compared with the short term indebtedness does not permit her to view with equanimity the gold drains.

(3). See my article on "Remonetisation of Silver" published in the *Indian Journal of Economics*, July 1931. *See* Appendix I.

de majeur. It is not, however, understood by these enthusiasts that artificial prices setting at naught the natural governing forces of demand and supply would be a menace to economic stability in the long run. Governmental intervention is being sought in the direction of raising the gold value of silver from the present-day natural low level to the highly artificial and theoretical level of 30*d*. an ounce.[1] The average price of silver as determined by the few figures available with reference to its price during 1927 to 1931 is far below the same which prevailed during the previous years prior to the recent war. The stable pre-war price was round about 30*d*. an ounce roughly. So the proposals are to delightfully raise the value to this particular level which will be greatly appreciated by the European, the Indian and the Chinese people. Obviously it would bring profit to the silver-producing interests of North America and Mexico* for the Governments which are parties

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[1] See Hon'ble (now Mr.) L. S. Amery's article on the Rehabilitation of Silver in the *Commerce* November 5, 1931.

[2] In July 1931, Mexico literally abandoned the Gold Standard although nominally it has retained the gold peso.

*The following table shows the chief silver producing countries and their annual output. *See* the Stastistical Year Book of the League of Nations, p. 142.

(in kilograms)

Continent.		1923.	1924.	1925.	1926.
Africa ..	..	72,950	79,700	63,850	60,950
North America	..	28,58,387	26,47,502	26,85,395	26,45,237
Central America	..	29,02,400	29,27,700	32,42,300	34,07,400
South America	..	8,51,500	8,32,700	8,86,400	9,88,800
Asia ..	..	3,18,400	3,47,400	3,60,000	3,80,000
Europe ..	..	2,78,000	3,17,400	3,57,000	3,71,900
Oceania ..	..	3,84,600	2,99,750	3,30,700	3,33,900
Total.		76,66,000	74,51,500	79,25,500	81,88,000

Continent.		1927.	1928.	1929.	1930.
Africa ..	..	64,700	61,800	66,200	..
North America	..	25,85,704	24,99,593	26,42,407	23,76,400
Central America	..	36,08,000	4,55,500	34,68,000	33,60,000
South America	..	7,92,200	9,04,400	9,12,700	..
Asia ..	..	4,05,[illegible]00	4,60,800	4,56,400	4,50,000
Europe ..	..	3,84,600	3,74,500	3,80,000	..
Oceania ..	..	3,74,300	3,12,300	3,26,200	3,43,000
Total	..	82,10,000	80,69,000	82,34,500	7,00,000

to the scheme would be literally carrying the industry at their own expense. The monetary "cranks" are gradually spreading this idea into the minds of many. But before this new idea is permanently approved it must be analysed and studied in all its manifold bearings.

In order to make the public amenable to their suggestions a great many evil consequences are being predicted if the fall in the gold value of silver is not immediately arrested by timely action.

OTHER SUGGESTED ADVANTAGES.

Apart from solving the present-day situation arising out of the maldistribution of gold stock the other distinct advantages which would follow the above timely action, viz., the raising of the price to 30*d*. an ounce, can be briefly stated to be as follows. Trade with silver-using countries like China, Mexico, and India would be greatly hampered as a result of further fall in the gold value of silver. As the value of their exports is cut down their own capacity to import foreign goods is correspondingly reduced to the value of their exports. "Exports pay for imports" is the most classical economic theorem which needs no elaborate proof here.

Nextly, the free introduction and investment of foreign capital in the silver-using countries would be jeopardised. Steadily-falling silver in the last seventies of 19th century acted as a severe handicap to the free, sober and reasonable investment of capital in the silver-using country. A similar situation would arise.

Governmental instability in the case of all the silver-using countries would be the inevitable result. Fast falling silver money means unexpected budgetary complications as the silver-using countries have to pay interest on their loan amounts in gold. The Central and South American Governments have been anticipating serious financial and political complications under this score.

Lastly, the value of the silver hoards would be cut down in due proportion to the fall in the gold value of silver. One modest estimate that has been recently framed is that these hoards have already lost 60 per cent. of their pre-war value. These financial reserves, if at all they exist,[1] would have to be sold at reduced value when the occasion or compelling necessity arises to sell them.[2] In short, the prognostications of these pessimists foreshadow that the economic development of the silver-using countries would be gravely handicapped.

Hence the "currency cranks" are exercising their ingenuity in devising new apparently plausible schemes to rehabilitate the value of silver. But the future price of silver may not be such smooth and plain sailing as these enthusiasts think or calculate it to be.

THE ARTIFICIAL PIRCE OF 30*d*. AN OUNCE.

An interesting case is being made out for the acquisition of silver at the theoretical price by the Governments of the chief silver-using countries such as India[3] and China and the Governments of the United States of America, and the United Kingdom. The silver-producer is to be protected and compensation has to be paid to him by the general tax-payers of these countries. The historical example of the U. S. A. Government's purchase of great stocks of silver at a high rate

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1 Of late, there has been a remarkable change in the monetary habits of the people. The shifting of Indian silver reserves into gold is a comparatively noticeable phenomenon of some importance in this direction. Secondly, the existence of widespread poverty along with these silver hoards cannot be reconciled as pertinent truths. The national vice of hoarding is nothing but an exaggerated myth and delightful schemes cannot be based or safely adumbrated on fabulous myths.

2 See the Evidence of Sir Charles Addis and the Right Hon'ble Mr. Montagu Norman in this respect before the Hilton Young Commission.

3 The plan of the International Chamber of Commerce is to sell silver at a very high price to the Government of India. It tacitly recognises that any scheme for the uplift of silver that does not include India is bound to be a tacit failure. Similarly if the Government of India were to sell silver at a price below the artificial price this would tend to drag down the price of silver.

in the last seventies up to 1893 is generally adduced in favour of this measure.[1]

ECONOMIC FRICTION.

This measure cannot however appeal to any clear-thinking economist. It requires these different Governments to go into business on a grand scale and it would probably involve immense wastes if the scheme is not carefully carried out.

Even granted that it is carefully carried out, the present-day difficulties would be intensified by perverting the price mechanism and bullion market machinery. A little elucidation of these points would be needed to enable the reader to grasp the real practical points at issue.

INTERFERENCE WITH PRICE MECHANISM.

The silver producers now find it difficult to sell the mined and "by-product" silver specially in a market where the demand for industrial use alone is prominent. The recent demonetisation of silver, even for subsidiary coinage purposes has completely changed or altered the demand factors for this metal. Seventy-five per cent. of the total silver production was formerly used for monetary purposes and twenty-five per cent. alone was absorbed in the arts. Silver was more a monetary metal than gold for more than thirty per cent. of

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1 The Bland-Allison Act of 1878 was the first silver purchase law of the U.S.A., Silver bullion, whose value was not less than 2,000,000 dollars and no more than dol. 4,000,000, had to be purchased every month and coined into silver dollars and added to the monetary circulation. Between 1878 and 1890 the U. S. A. Government purchased the minimum quantity monthly and roughly dol. 352,000,000 were added to the monetary circulation. The famous Sherman Act was passed in 1890 and was in force for a period of three years. The U.S.A. Government had to acquire monthly 4,500,000 ounces of silver. About dol. 218,000,000 were added to the circulation. The price-level did not however respond quickly to these additions of purchasing power. The silver inflation however kept the American price-level about the world level and tended to drain gold out of the country. The financial panic of 1893 in the U. S.A. led to the repeal of the silver inflation measures.

gold's demand arises out of industrial use and roughly two-thirds of the gold output alone is used for monetary purposes.[1]

Now that monetary demand for silver is being given up in India, in the Eastern countries and in Siam the excessively high stocks resulting out of unabsorbed silver bullion cannot be disposed off at the theoretical price. This great discrepancy between the theoretical price and the natural price cannot be checked all of a sudden. So the slow and painful process of Governmental purchase or block-purchase by a Silver Syndicate[2] is recommended to enhance the market value of silver.

The U. S. A. and the United Kingdom and Indian Governments are to store this silver secured at a high price and use it for subsidiary token coinage purposes. Mere hoarding like a proverbial miser gloating over his stocks of precious metal will not be of any great avail. The deriving of mere psychological and aesthetic pleasure in holding comparatively large stocks of silver will not be a significant thing or advantage.

Possible increased output of silver.

Under the conditions of Governmental block purchase at the high theoretical price the silver output might be stimulated. No attempt will be made to discover diversified uses for silver. It cannot be considered as a mere emergency measure for silver stock is bcoming too great even for all the present-day uses. The increased stocks will result out of

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(1) The Gold Delegation estimates the total demand for non-monetary purpose at about $ 200 millions per annum out of a total of $ 400 millions and the balance is generally utilised for monetary purposes.

(2). It is announced in the newspapers that a London Silver syndicate is acquiring 600 mil. ounces of silver from the Secretary of State for India. The object is to unload it slowly at a greatly enhanced price. viz., at 15 per cent. higher price than the present-day market price. This reminds us of the Syndicate which purchased the unsold silver stocks of the cornered commodity of the late Mr. Chunilal Saraiya and the successful way in which it unloaded the silver stock. But times were undoubtedly propitious then as the Governments were making good use of silver for subsidiary coinage purposes. Such daring marketing manoeuvre cannot be immediately successful in a market where the monetary demand has altogether been given up or forsaken.

(a) "the mined output which might be stimulated as a result of the very paying prices" at which Governments would be forced to acquire silver; (b) the by-product silver would also increase to secure this enhanced price; (c) the released silver coinage hoards which would be sold off at this high theoretical price to the above Governments.

The reduction of output of silver will not take place under the above scheme. The plan itself would have to be stretched over a ten-year period and might be forced to become a permanent one. Government funds would always have to be wasted on the somewhat barren undertaking of raising and steadying the price of the glut of silver products, both mined and by-product silver as well. Even granted that silver mining down to the last marginal miner can be effectively controlled by the Silver Selling Syndicate the millions of by-product silver cannot be satisfactorily dealt with so long as these base metals—lead, copper and zinc—are produced. The released stocks of Governmental silver would flood the market. The economic law of the doctrine of value concerning composite supply cannot be broken with impunity.[1] Unless and until the production of other metals is restricted there would be no diminished production of silver to satisfy the decreasing demand in the world market.

Meddlesome Interference.

Barring a temporary fillip and a restoration of confidence in the value of silver no permanent raising of the price-level to the theoretical level of 30*d.* can be secured. Acquisition at a higher price stimulates silver production. More

[1] This law says that when two products are being produced jointly the fall in the value of one must be compensated by the rise in the price of the other product so as to cover the cost of production such as mining, smelting, refining and transportation to market. Silver, zinc, copper and lead are produced and if the value of silver were to fall the value of copper, lead, and zinc should rise. If silver is allowed to fall in value more money must be paid for copper, zinc and lead if their use is desired by the leading industrial nations. *See* F. H. Brownall's Address before the Mineral Law Section of the American Bar Association, Atlantic, City, Sep, 16, 1931.

by-product silver means more of the jointly produced metals as copper, zinc and lead. These would have to be sold at lesser price than at present. Their price has to be depressed to that level which just pays the mining business. If this were not to be the case the increased profits under the enhanced price of silver and the profits under the jointly produced metal would be too tempting to be resisted by the producers. There would literally be a surfeit of four metals under this scheme. The scheme of "boosting" up of the price of silver might inevitably lead to the Governments getting out of business if they were to saddle themselves with such an undertaking. Ultimately, in my judgment, a period of ten years would make the situation worse and more confounded than at present. A worse situation will have to be faced by the silver-producers. The price mechanism of as many as four conjointly produced metals will have to be tampered with in order to realise this cherished consummation. The prices of these metals are now being determined in the open competitive market under a regime of "free enterprise and private property" as the economic jargon would put it. Stocks of these metals are being ruled in the long run by prices prevailing in the market. The economic function of the market price is to tend to restore industrial balance in the matter of production. This is the pivotal base of economic activity not only in mining but in any field of human enterprise.

Arbitrary control.

The socialistic notion of controlling the consumption and production of four metals, silver, lead, copper and zinc, is bound to fail unless there is an elaborate and scientific planning of the most exact kind. It would involve the control of many other activities of the people on the part of these silver-producing and silver-purchasing Governments. The final up-shot of this course of action would be that a vicious circle of arbitrary Governmental activity involving almost a world-wide control of markets would be initiated. The

scheme is bound to collapse just as all other schemes for cornering the silver and copper metals proved illusory. The mediaeval conception of considering metallic bullion as wealth is an old and downright fallacy. Even the man in the street with hardly or any modicum of economic knowledge would not believe it to be the truth.

Fiasco in Public Finance.

Most of the foreign consumers of silver would murmur at this declaration of the theoretical price in a high-handed manner by the Syndicate of the silver-producing countries. International trade relations would become strained as a result of the unnatural Governmental activity. The Governments have to strain their taxing capacity to gather the funds needed to raise the present-day market price of 17*d*. an ounce to 30*d*. an ounce. A great fiasco in the field of public finance would ensue as a result of this attempt.

Check to Industrial use.

The last and the most formidable obstacle is that a high theoretical price would check the industrial use or absorption of silver by the people. Take China and India, for example. More imports of silver generally take place into these countries as soon as the gold value of silver falls. Similarly when the value of silver rises the industrial use receives a rude check. The following tables[1] concerning the supply of silver and its absorption are highly instructive.

Tabular Statement I.[2]

Silver Supply (Millions of Fine Ounces).

	1920.	1921.	1922.	1923.	1924.	1925.
Production	173	171	210	246	239	245
Demonetisation sales ..	44	41	50	41	4	6
Total ..	217	212	260	287	243	251

[1] This as well as the following table are taken from the article entitled "The fall in the value of silver" by F. D. Graham,—*The Journal of Political Economy*. p. 468,

[2] Compare these tables with those of the *Economist* No. 4590 March 1932 p. 662. The *Economist's* figures are from an unpublished paper of Mr. Joseph Kitchen.

	1926.	1927.	1928.	1929.	1930.
Production	254	254	258	262	241
Demonetisation sales ..	2	25	71	53	71
Total ..	256	279	329	315	312

TABLE II.

Absorption of Silver (Millions of Fine Ounces.)

	1920.	1921.	1922.	1923.	1924.	1925.
Net Imports of India plus domestic absorption of Indian Treasury sales and of home production ..	6	57	72	98	91	105
Net Imports of China ..	113	39	48	82	32	75
New Coinage in Occident ..	40	69	56	57	71	17
Industrial use	45	53	58	55	53	59
Total ..	240	218	234	292	247	256
Unaccounted for	—13	6	—26	4	5	5

	1926.	1927.	1928.	1929,	1930.
Net Imports of India plus domestic absorption of Indian Treasury sales and of home production ..	111	108	80	68	101
Net Imports of China ..	65	9	130	129	130
New Coinage in Occident ..	31	47	21	36	16
Industrial use	57	58	53	60	50
Total	264	292	284	293	297
Unaccounted for ..	8	13	—45	—22	—15

The following conclusions can be safely drawn from the above tables. Since the fall in the price of silver commenced in 1920 there has been greater absorption of it in the industrial arts. Were the price to rise rather to a great extent the result would be lessened industrial use.

Secondly, the new coinage demand in the Occident is falling. Although the use of silver is recommended in place of smaller cheques and credit instruments so as to bring about an economy of gold, for lesser gold would be needed for the lessened credit structure, still the Occidental countries have not translated this recommendation into actual practice. Since Great Britain reduced the mille-simal fineness of her silver tokens from 900 to 500 in 1920 and sold the released stocks of silver other Governments have followed suit. This unrestrained dumping of unwanted stocks of monetary silver has given a staggering blow to the value of silver. The Hilton Young Commission almost sealed its fate as a monetary metal and its plan of ultimate dethronement of silver meant immediate drop in its value. Most of the Eastern Governments have added fuel to the fire and thus there has been a steady deterioration in the value of silver as 63 mil. five ounces were being sold on average in the last three years by Great Britain, France and Indo-China.

The final death-blow to the monetary use of silver would have been imparted long ago had the Kemmerer Commission's recommendation to China to adopt a Gold standard in place of the present-day standard and the entrusting of its management to a newly created Central Bank been carried out in practice. Political chaos and uncertainty have prevented the scheme from being carried out *in toto*.* The temporary abandonment of the gold standard and the agitation to set up silver as a monetary metal once again to secure the much needed relief to gold have revived somewhat false hopes in the minds of the silver-producers. But we have already examined the main proposal of artificially fixing a high theoretical price of silver and its consequences. The next article will be devoted to the other quixotic proposals for the rehabilitation of silver.

*A State-owned Central Bank was created in China in 1928.

THE STABILISATION OF SILVER (PART II).

The Three Forms of Remonetisation.

Attention was drawn in the previous article to the single remedy of outright purchase at the theoretical price of 30*d*. an ounce. We have discussed the dangers attendant on this measure. The stored-up silver cannot be released for industrial purposes at a high price. It can only be made use of for monetary purposes in one form or other. The plans framed for increasing the monetary use of silver will have to be examined in this article. Three variations of the remonetisation proposal can be discerned. These three measures, viz., Central Bank Note-cover, bimetallism and the revival of pre-war status, are planned out or meant to straighten out the real difficulties of the silver producers who will have to continue their over-production and still realise profit.

Note-cover.

Of the three forms of remonetisation proposed the most important one is the declaring of silver as legal tender and compelling Central Banks of Issue to redeem a part of their obligations in silver as the Bank of France sometimes did in the previous century. This suggestion has emanated from the Federation of the British Industries and the Empire Economic Union. [1] It proposes that Central Banks should pay ten per cent. of their maturing obligations in silver and silver alone. To place silver as part cover of the bank notes is the gist of the above proposal. This suggestion is nothing but an attempt to revive an abandoned practice. The Bank of England was permitted by Section III of the 1844 Bank Charter Act to place silver up to one-fourth extent of its gold

[1] *See* the Newspaper Report of the Committee's recommendations on Empire Currency and Finance, the *Statesman*, p. 10. Nov. 8, 1931. The same idea is repeated by Sir Hugo Cunliffe Owen, Chairman of the British American Tobacco Co., Ltd. *See* the *Englishman*, Dec. 14, 1931, p. 11.

holdings in the reserve. An extension of this practice is desired by the advocates of this proposal. The main object is to enable silver to carry the credit load along with gold as its sister companion. An organised purchase on the part of the Central Banks would have to be made to enable them to store silver in their portfolios and make payments in legal tender silver against the Bank notes and other liabilities. This would mean increased effective demand and would immediately help the Governments in their stabilising activities.

Difficulties of the Scheme.

Although the immediate objective of raising the price of silver by means of concerted action would be forthcoming still there are certain difficulties attendant on this measure. If repayment in silver bars as is the case with gold bars in the gold bullion standard is the objective, it would bring about economy in the use of precious metals. A return to coin usage would be a retrograde step in the monetary field. [1] It would be forgetting the salient lesson taught to us during the war period. There should be uniform action in this respect on the part of all banks and a uniform percentage selected so as to disarm criticism. Granted that this is secured by international co-operation it does not solve the real monetary problem. The "money illusion" must be shattered as Prof. Fisher so ardently proclaims. Sound, stable and elastic money can never be realised under a single metallic standard, viz., be it gold or silver or bimetallism consisting of the joint use of gold and silver.

Possible Rise in the Price of Silver.

Nextly, if the organised purchase on the part of the Central Banks were to reinforce the arts demand for silver the inelastic supply would lead to the failure of the experiment.

[1] Of late all the Governments of the Eastern countries have been wisely rejecting all forms of metallic (silver) payments in their composite monetary standards. So the total coinage demand for silver has fallen from 42 to 28 mil oz during the last five years. See the Statesman, p. 8, 23rd October 1931.

The rise in the price of silver ensuing out of a scramble on the part of the Central Banks would lead to the breakdown of the experiment. The total note issue of the important Central Banks of the World amount to a high figure as shown in the following table.

Note circulation in 1930 of some important C. Banks and Governments. (000,000, omitted).

Country.	Bank.	Government.	Total.
South Africa (£)	8·5	....	8·5
Egypt (£.E.)	....	....	21·0
Canada (Dol.)	....	....	201·0
U.S.A. (Dol.)	2267	296	2563·0
Argentine (Peso)	....	1261	1261·0
Brazil (Milreis)	....	....	2771·0
Poland (Zloty)	....	....	1331·0
Roumania (Leu)	19605	....	19605·0
U.R.R.S. (Rouble)	....	....	4027·0
Yugoslavia (Dinar)	5397	....	5397·0
Australia (£)	42·5	....	42·5
New Zealand (£)	6·7	....	6·7
Japan (Yen)	....	....	1557·0
Germany (Mark)	5398	....	5398·0
Belgium (Franc)	....	....	16532·0
France (Franc)	76156	....	76156·0
Italy (Lira)	....	....	15680·0

In the above table[2] the total note circulation of the Bank and the Governments has been placed before the reader. Sometimes the total figure alone is given. This is due to the unavailability of the detailed issues of the Bank and the Governments. The figures are stated in the currencies of the respective countries. The bracketed expression is the currency denomination of the country. In addition to these some of the Governments have been issuing coins also. But these figures are deliberately excluded by me as the metallic coins contain a cover within themselves which varies according to the value of the precious metal contained in them.

[2] The figures in the table are taken from the Statistical Year Book of the League of Nations—1930-1931, pp. 220-222. As for the reciprocal parities of the different currencies, see Table I of the same publication, pp. 12 to 15.

If the Governments and the C. Banks were to so decide that payment of the note liability to the extent of ten per cent. were to be made in silver alone most of these which are storing gold assets alone will have to change their composition. Literally they will have to give up storing gold to the extent of silver reserve they mean holding according to this provision. The demand would be so great that the experiment would fail on account of the unavailability of silver to satisfy their huge requirements under this heading.[1]

But it can be argued that the Central Banks and the Governments might be granted the privilege of paying gold or silver according to the Central Bank's convenience. Such a salutary safeguard can be enacted. A provision to this effect was engrafted in the charter of the Bank of France. Prior to the year 1928 when the Gold Bullion Standard was adopted the Bank of France could legally pay its obligations in Five-Franc Silver pieces if it desired to do so. A similar provision that these currency authorities can pay in silver or gold would make it a workable proposition. But considering the fact that silver supply might not expand to such an extent as to satisfy this newly arising demand this suggestion cannot be applauded as a safe solution.

THE SILVER CALF.

It would lead to setting up the silver calf along with the Golden calf on the monetary pedastal. So long as productive credit is tied up to such illusory metallic bases as gold and silver the credit machinery will not smoothly function. Such credit cannot expand to meet the producer's demand. But what guarantee is there that paper will not take the place of silver as it did in the case of gold ? The weight of gold as well as silver will be prohibitive and go against their use. Silver certificates will be their representatives.

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[1] The 1930 production was far lower than that of 1929 and it is stated that the 1931 production would be lower than that of 1930. See Mr. Kirk's article on Silver in the *Economic Journal*, Sept. 1931, p. 393.

Natural Reluctance of Central Banks.

The present-day natural reluctance of the Central Banks to store silver has to be overcome.[1] In the past they have discarded silver as it became very cheap and plentiful. When the Bank of England made an attempt to increase its silver holding somewhat up to the limit permitted by the 1844 Bank Charter Act as part of the metallic reserve against the Bank notes this attempt was vigorously decried and since the "mother of all Central Banks" led the way the other Central Banks of the gold-using countries have been unwilling to treasure the fast cheapening metal, viz., silver. Such was the case of the historical failure.[2] Unless an intelligent and co-ordinated action through the Central Banks is brought about the value of silver might not rise to the theoretical price and get fixed at that level for comparatively long time.

Payments in Silver.

It has also been suggested that silver should be used to pay a portion of the Inter-Allied Indebtedness and Reparations Debt to America and to each other in turn. This sort

[1] Formerly most of the Central Banks of the Latin Union held vast quantities of silver in their portfolios when they were adherents of bimetallism. The following table gives one an idea of the quantities coined and the Bank holdings of silver.

Quantities coined.		*Bank holdings.*	
Fance (1866-1878) ..	£ 25,000,000	Bank of France ..	£ 49,480,000
Italy (1866-1879) ..	£ 14,360,000	Belgium National Bank..	£ 800,000
Belgium (1866-1876) ..	£ 14,000,000	Bank of Italy ..	£ 2,120,000
Switzerland (1866-1876) ..	£ 320,000	Swiss Bank ..	£ 480,000
Greece (1866-1876) ..	£ 600,000		
	£ 54,280,000		£ 52,880,000

See B. A. White—Silver, Its History and Romance, p. 284.

[2] Quite recently Germany determined to steady the Gold standard by restoring silver as monetary metal. She is buying silver for minting the same and about 120,000,000 marks are minted for internal circulation. *See* Reuter's Telegram from Berlin—Oct. 31, 1931—quoted from the *Statesman*.

of payment has to be validated in course of time by the receiving countries. The famous Pittman Act of 1918 (U. S. A.) contains a similar provision as the above one. With the aim of conserving the gold stocks of the country it permitted the settlement in silver of trade balance adverse to the U. S. A. The paying or the borrowing countries can easily hope to pass such a resolution but it is the receiving or the lending country that has to accept it. So long as Silver's value is cheap and unsteady there can be no such international acceptance which this suggestion anticipates.

After all if the U. S. A. were to be saddled with so much of silver it will not solve the monetary problem. Such a provision might temporarily enhance the value of silver but permanent stabilisation at an artificially fixed high price cannot be maintained without undergoing some economic sacrifice. Is this sacrifice worth while for simply storing silver as metallic bullion which after all is not real wealth ?

Bimetallism.

The second variation of the scheme is to make the important nations adopt bimetallism and make it international in scope if possible. Academically speaking, this form of the proposal is free from theoretical criticism provided it is all-pervading or universal in its scope. Were all countries to adopt a fixed ratio between silver and gold*, the varying rates of production of the metals would not succeed in varying the price of the metals. The combine of the different mints of the countries can regulate the value of the precious metals. The present-day fluctuations in the separate value of gold and silver are far greater than are desirable. This would not be the case under bimetallism. The value of gold and silver together in the joint standard would be steady. But if the production of both the metals were to be greater than the monetary needs

* Senator Borah proposes the ratio of 14 : 1 between silver and **gold.** *See Statist*, Oct. 24, 1931.

and the industrial demand of the nations the experiment would prove a failure. Gold monometallism was selected by almost all European countries as they found that both gold and silver were being produced very fast and to avoid inflation of currency they discarded silver, the less precious metal. But as every keen student of monetary economics knows, bimetallism has the unfortunate defect of degenerating in course of time to an alternating standard according to the undervaluing or overvaluing of one of the metals brought about by varying rates of production. That the undervalued metal disappears from circulation and an alternating standard would be the new monetary regime is too well-known to the advocates of bimetallism. The most ardent advocate of international bimetallism does not claim for his scheme any greater virtue than that of imparting greater stability to the value of the precious metals than is the case at present. The greater the expanse of territory belonging to the International Bimetallic Union the longer would be the scheme in operation. But as Dr. Shaw points out clearly, " any and every system that the art of man can devise which attempts to link the two metals together will break down ".

Conditions of Success.

One thing which the advocates of international bimetallism have to bear in mind is that the arbitrarily selected ratio between gold and silver would have to be particularly conducive towards a rise in commodity prices. If the Mint price of one ounce of silver is fixed arbitrarily in such a way as to raise the present-day gold price of silver[1] and if the monetary circulation were to be augmented the commodity prices would rise. Nothing is more important than this. Were the gold

[1] Mr. H. E. Moon in his recent pamphlet on silver and bimetallism makes allowance for this suggestion. Without bringing about an all-round temporary stimulus by slowly rising commodity prices this mometary reform will not cure this present-day world trade depression. But so long as tariffs hinder the free flow of goods a mere monetary remedy cannot cure the present-day position.

price of silver to rise the silver interests would be pleased. Decreasing gold can be augmented by its old help-mate—Silver. Lasting ties of friendship can again be forged between the two metals. Falling commodity prices under a regime of decreasing gold stock is the world's monetary bugbear. This can be remedied. Silver would rise in the estimation of the public and this would satisfy the silver interests for the time being. It would mean, as in the previous case, a criminal waste of the tax-payer's money on the part of the different Governments. It would lead to a world-wide waste of energy.

Does not solve the main monetary problem of changing values ?

A vigorous controversy on bimetallism would again be launched upon by the currency enthusiasts. But the real issue in currency matters is to attain comparative stability of prices. Whether the currency standard should be tied to this metal or that is not the criterion. Any real monetary advance cannot be secured by resort to international bimetallism or by managing the gold standard in such a way as to yield complete satisfaction to all. Even the improved gold standard cannot give tolerable stability to the price-level. There can be no adequate and rational solution to the question of our stable standard which would have to reward equally all human efforts and secure equal justice to all classes of society if silver were to be merely substituted in place of gold. Popular allegiance was unfortunately wrongly shifted from the silver metal to the gold standard which was adopted by Great Britain in 1816. During the years 1873 to 1893 silver proved to be a more stable standard than gold.[1] But the fascination

[1] *See* E. W. Kemmerer "Modern Currency Reforms", p. 21. He proves conclusively that the silver standard of Shanghai was more stable than that of the gold standard of England. It was the value of gold that was appreciating and caused the instability. But as Sir Charles Addis says," the superior convenience and economy of gold has enabled it to oust silver as a medium of international exchange." *See* his introduction to Benjamin White's" The History and Romance of Silver " p., viii.

of the yellow metal or the compelling necessity of having a common standard with Great Britain and her vast Empire countries forced Germany and other countries to abandon silver and adopt gold monometallism. But silver has lost its fascinating hold nowadays except on the Eastern masses. It is no longer a metal of international acceptance.

RESTORATION TO PRE-WAR STATUS.

The third variation of the remonetisation scheme is as follows. It proposes to restore silver to the pre-war status, viz., the attempt is to make Governments agree to use silver for subsidiary coinage of the old fineness.[1] Secondly, they should not sell their unwanted stocks of silver in the glutted market without informing the Silver-selling Syndicate of their action. This Syndicate or Corporation would have to inform the respective Governments of the actual state of production and the market conditions of silver. Thirdly, there need not be any interchangeability between gold and silver. They will circulate in complete independence of each other. This modest proposal is formulated by Mr. Brownall, Chairman of the American Smelting and Refining Company of New York.

COMPARISON WITH OTHER SCHEMES.

Of all the above schemes this is the least harmful. It has the merit not only of not sacrificing the silver interests but pays proper heed to the position of gold. It aims at setting a *parallel standard* and not a *double standard* as in the case of of bimetallism. In the earlier forms of the remonetisation schemes the consequences befalling on gold have not been borne

[1] As the price of silver began to increase an increased use was made of nickel, bronze, and paper as subsidiary money. These Governments now seem to have fallen too much in love with these substitutes to wish for the reinstating of silver coins which would be costly. Since Oct. 1931, the price of silver is on the ascendancy and if the theoretical price were to be the ruling price this substitution can never be thought of.

in mind. The value of gold would fall as soon as monetary demand would not press hard on the dwindling gold stocks. It might be that it might afford a suitable and welcome relief just at present as gold stocks tend to dwindle according to the monetary prophets. From the standpoint of modern finance the use of silver coins also has to be discarded for the corresponding wear and tear of silver coins also would amount to a culpable waste and criminal folly.

Its Effects on Governments.

This scheme would stimulate effective demand for silver and would regulate the supply of silver to be disposed off in the world markets. But the Governments of the silver-using countries would consider this step as an "organised loot" and mere "legalised plunder". Having once discarded silver even for subsidiary coinage purposes they would be forced to retrace their steps and begin the recoinage of silver token coins. As this step does not enable them to reach the monetary goal they will hardly have real and abiding sympathy for this modified scheme. A Sir Robert Horne might plaintively raise the cry that as "Governments have muddled it is Governments that must provide the remedy". As a member of the joint standard silver would have to be welcomed by these Governments. Gold and silver would be circulating without having any interconnection, fixed ratio for interconvertibility or any other form of reciprocal relationship.

Can the promised goal be realised ?

Granted that the least harmful variation of the remonetisation scheme is adopted does it mean that all the much-talked-of advantages would be immediately realised ? The first and the most patent disappointment would occur in the field of the enhanced purchasing power of the Eastern masses. Even granted that silver lies dormant in small hoards here and there in India, China and the Eastern countries it does not

immediately follow that their purchasing power would be enhanced. These jewellery hoards will have to be melted and sold as bullion before enhanced purchasing power can be possessed by them. Even supposing that this would take place it does not immediately follow that these Eastern masses will purchase the European manufactured products alone. Plain living and high thinking characterise the ambitions of the Eastern people. The tawdry products of the modern industrial organisation of the Western countries make no immediate appeal to them. They do not want more wants. It would not be far wrong to consider them as the direct antithesis of the " economic man ".

CONCLUSION.

Any hasty action is detrimental to several interests. Unless the International World Conference on Silver[1] which the Washington Government is about to organise or the League of Nations were to outline a consistent course of action with reference to silver a policy of masterly inactivity has to be pursued by the silver-using countries. The artificial fixation of the price of silver would be an economic error or a Himalayan blunder. General social welfare cannot be promoted by hasty and panicky legislation in this direction. It does not bring us any nearer the monetary goal. Changing price-levels are the curse of the present-day economic organisation of the most advanced countries. It is for society to " sense " these evils and try to rectify the same. No metallic standard can hope to combine effectively the dual rôle of acting as the medium of exchange and a reliable store of value at the same time. Why then revive silver as a monetary metal ?

[1] The Right Hon'ble Neville Chamberlain has rightly discarded this proposal and without the Government of the United Kingdom being represented any proposal to hold an international discussion would be futile.

As for the future of silver, the only sensible suggestion is to increase the different uses to which it can be put. Scientific research must play an important part in any wisely conceived plan for the rehabilitation of silver.

To reiterate all that the Eastern Governments may do is to mint more subsidiary silver coins and perhaps also raise the amount for which they can be declared legal tender. This is the utmost help that can be safely granted to the silver interests if at all they deserve any mercy. But they must not agree to pay a high price as suggested by Hon'ble (now Mr.) L. S. Amery or some of the American silver producers. Nothing further can be done to protect the silver interests and it is an idle dream to expect that silver will at any time emerge from the days of its present humiliation.

APPENDIX II.

INDIA—THE GOLD STANDARD—THE PRESENT CRISIS[1]

The dominant concern at the present time is the subject of the gold standard. Mr. Philip Snowdon has announced his intention of summoning an International Conference to discuss the possibility of bringing an equitable distribution of gold and thus internationalise the gold standard.

But what is the modern gold standard whose meaning, scope, limitation and interpretation are radically different from that of the pre-war gold standard and whose suspension has created so much stir ? A country is said to be on the modern gold standard when the domestic currency or monetary units are made convertible into a definite fixed weight of gold. There is either *de facto* or *de jure* linking to gold. The value of all commodities and services are measured in gold and all deferred payments are made payable in legal tender money which itself is convertible into gold bullion bars. Gold is used as the backing for internal currency and used for adjusting inter national obligations arising out of a multitude of individual payments, exchange of securities and services on the part of the people of one nation to another. If gold has won an accepted position as a regulator and governor of commercial and financial values in any country it can be stated that that country is on the gold standard.

In England the relationship between gold and the other money units is fixed arbitrarily and artificially by the Bank Act which says that the Bank of England must sell gold on

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[1] This paper was read before a meeting of the Bengal Economic Society on 5th Oct., 1931. Mr. D. P. Khaitan—Member of the Central Banking Enquiry Committee, presided and extclled the highly scientific character and the accuracy of trained processes of economic reasoning indicated in the discussion of the subject.

offer of other forms of legal tender money at the rate of 400 ounces at £ 3-17*s*.-10 and ½*d*. an ounce. An abrogation of this sale of gold means the suspension of the gold standard by the country. This is the most liberal interpretation of the meaning of the suspension of the gold standard one can give. Norway, Sweden and Denmark are off the gold standard already. It would not be a surprise if the other debtor countries of the world finding it impossible to part with their dwindling stocks of gold determine to be off the gold standard. These countries might try to refuse to tie " their currency and price-level ships to the common buoy—gold." Unstable currencies with bewildering rates of exchanges will be the prevailing monetary phenomenon.

The following table shows the gold holdings of the Central Banks of some of the important countries. If some of these do depart from the gold standard as a result of the departure of gold from the banking system there would be no surprise.

GOLD IN MILLIONS OF DOLLARS.[1]

Country.	Held at the end of 1930.	Increase 1925-1930.	Decrease 1925-1930.
U. S. A.	4,225	240	—
France	2,099	1,388	—
United Kingdom ..	722	18	—
Germany	544	241	—
Spain	471	—	19
Japan	412	—	164
Argentina	411	—	25
Italy	279	58	—
Russia	249	155	
Canada	194	—	32
Belgium ..	191	138	—
Netherlands	171	—	7
Switzerland	138	48	—
India	126	17	—
Total	10,232	2,303	247

[1] This table is taken from the Statistics of Gold Movements in the selected Documents on the Distribution of Gold submitted to the Gold Delegation of the Financial Committee of the League of Nations, pp. 65-67.

The small holdings are not taken into account in the above table. Australia, Brazil, Chile, the Dutch East Indies and Denmark have lost gold to a certain extent, while Poland, Austria, Hungary and Czechoslovakia have increased their gold holdings.

THE GOLD STANDARD IN INDIA.

Even according to the previous understanding of the gold standard system the present-day Indian currency system cannot be said to be a gold standard one. Some of the Indian economists refuse to consider the Indian currency standard as a gold standard one.[1] The value of goods and services in the country is measured in terms of the rupee. But the psychological abstraction of the "gold rupee" which the gold bullion standard requires is not realised by anybody. The postponing of the standard and the Reserve Bank Bill of 1928 meant that a kind of exchange standard is being maintained. But in the remote sense that the rupee was converted into pound sterling currency which was equivalent to gold we can indirectly claim to be on the gold standard basis.[2] However, there is a world of difference between the giving of gold, bars and sterling. No sooner was sterling given for domestic currency the rate of exchange became the arbiter of the volume of currency. Instead of changes in the internal purchasing power of money from its parity with gold being considered as the proper data for ascertaining the deficiency or superabundance of money, the rate of exchange has become the all-important factor. Thus India has been on the gold exchange standard basis.

MISGUIDED ENTHUSIASM.

There are several people who entertain highly elated notions concerning the desirability of suspending the gold standard at this juncture. Whether gold is to be had or not

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[1] *See* Prof. K. T. Shah, Evidence, Hilton Young Commission, Qn. 8870.

[2] The Macmillan Committee says, "For an effective working of the gold standard it is sufficient if the local currency is exchangeable for another currency which is itself convertible into gold", p. 19.

the mere suspension would grant a temporary fillip to trade which would have to be greatly welcomed in the days of world depression. But the export bounty arising out of depreciated currency cannot be reaped if a large number of countries are off the gold standard. Traders and businessmen who feel the pinch of ready capital which cannot be obtained at low rates of interest denounce the rigid gold standard as a "fraudulent standard". But without convertibility into gold the currency standard can be vigorously abused to secure certain temporary measures. Hence the twin methods by which the efficiency of any monetary system is secured are the well-known principles of convertibility and limitation. The first might be a mere facilitating principle but without the observance of the second there can be no successful regulation of the currency standard. Without proper observance of the limitation principle the test of convertibility cannot be secured for any considerable length of time. Both can exist together and flourish like the proverbial Siamese twins. The existence of both these safeguards will make the standard "knave-proof or fool-proof". I strongly demur to the false notions of elation and illusory prosperity which are supposed to be the attendant advantages on a country pursuing the path of the suspension of the gold standard. Mere suspension by itself is not attendant with grave risks. But it means you have set foot on the inclined plane and there will likely be a rapid downward slide. Mr. McKenna correctly observes that "the fear of being forced off the gold standard acts as a salutary check on the extravagance of Governments who might be willing to face a mere fluctuation in exchange but would not dare to suspend the specie payments".

INDIA OFF THE GOLD STANDARD.

The Ratio Act of 1927 has familiarised the people with the conception of the "gold rupee". The rupee was linked to 8·4751 grains of gold. Domestic silver rupees and paper currency are to be converted in certain minimum quantities into gold bullion bars of 1065 tolas at Rs. 21 11*as*. 9 *p*. per tola

each. These gold bullion bars which ought to have been available to the people *whenever and for whatever* purposes they demanded it, have not been made available even for exportation purposes. But to discharge this obligation sterling, which was equivalent to gold, was allowed to be given at 1*s*. 5*d*. and 49/64*d*. It was *not actual practical conversion* into gold bullion bars but *mere theoretical authorisation* that existed in the Indian Gold Bullion standard system. This regulated goldless silver rupee standard commonly designated as the gold bullion standard has broken down at the present time. Due to the lack of gold bullion bars the provision for the sale of these proved to be a mere eye-wash and the *de jure* gold bullion standard worked out in the practical field proved to be a mere *de facto* gold exchange standard. The convertible rupee was converted into sterling or gold exchange. The suspension of the gold standard in England completely altered the position for the sterling has become an inconvertible paper currency whose internal value at least ought to depend on mere output. If budgetary or fiscal causes were to inflate the paper pound sterling it would become depreciated in value. Instead of considering the present moment as a grave emergency and suspending the sale of gold or sterling according to the Act of 1927 the rupee has been linked to sterling at 1*s*.-6*d*. ratio, even without the consultation of Indian public opinion.[1] The Finance Member is no longer calm and at ease. Like the sea captain who, finding his ship moored to a buoy that has been anchored to nothing, feels ill at ease so also our Indian Finance Member finds his currency ship anchored to the sterling buoy which finds itself drifting wherever the currents of political uncertainty or financial instability might tend to take it.[2]

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[1] The pros and cons of linking the rupee to sterling or gold or leaving it to find its normal level are carefully elaborated in Appendix I.

[2] *See* the Report of the Babington Smith Committee, Para. 34.

PRACTICAL CONSEQUENCES.

The first Ordinance suspending the sale of reverse drafts according to the terms of the 1927 Act was wisely conceived and boldly promulgated. The Bank of France had on several occasions to suspend cash payments. The British Government often suspended the Bank Charter Act. Such suspensions can be easily justified on the ground of national emergency. The failure to operate an inconvenient ratio meant after all exchange instability. Exchange would have been forced to find its own level. The independent rupee not convertible into sterling or gold would have depended for its internal value on careful regulation. Its immediate external value might have been depending on the confidence reposed in its stability by foreign businessmen and traders. Though a temporary set-back might result due to lack of confidence she would have quickly recovered from the shock. The external value of the rupee would have been proved by its own virtue. There would perhaps be no surprise if it were to fall to a level worth its weight in silver. This would certainly take place under a regime of inflation. But the evils of fluctuating exchange have been magnified though authoritative Committees[1] have reiterated the opinion that, exchange stability is a matter of convenience and "important facility and not an essential condition". Indian trade flourished during times of unstable exchanges. The experiences of 1870-1890 need not be recounted. Even during the days of rising exchange, as in the years 1921-1925, trade did flourish.

At the behest of the Secretary of State for India the rupee has been linked to sterling which has depreciated in terms of gold. This enforced departure from the *de jure* gold bullion standard or the hardened *de facto* gold exchange standard has destroyed public faith in the rupee or the monetary unit.

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[1] I am indebted to Sir H. Strakosch for this metaphor.

This alteration of the monetary standard is nothing but a serious moral offence and a violently grave breach of national faith as the gold standard countries would put it. This arbitrary fiat can be justified on the plea of grave economic necessity. But the end has to justify the means. If external trade and internal business operations which have almost come to a stand-still on account of the high internal value of the gold rupee were to be rejuvenated by this alteration of the legal standard there would be some justification. But it is too early to say how real good can be conferred on India by this measure. Will it be anything more than a temporary solution if the rupee is linked to sterling and the more fundamental cause for bringing about relative stabilisation of international prices is neglected ?

Economic Implications.

The implications of this sudden departure from the administrative practice of the Government have to be fully realised. Firstly, it means that the Secretary of State is all influential in initiating any monetary policy and carrying it out even without consulting the wishes of the Government of India or Indian Legislative Assembly. A matter-of-fact economist of my stamp cannot hope to comment on this situation except by repeating the conviction that the present-day regime of divided financial control between Whitehall and Simla has to be remedied at the earliest possible opportunity.

Secondly, it has made the currency authority control all exchange operations so that the contractual obligations of genuine traders and the real domestic requirements might be fulfilled on 1*s*. 6*d*. sterling basis. Illegitimate and speculative requirements would be curbed to a certain extent and in so far as the Ordinance can be avoided there would tend to be a drain of gold resources of the Government. Exchange control was once experimented with in 1920. Reverse Councils were sold in limited quantities to the specially selected banks. The needs of the

genuine small remitter were not only overlooked but as soon as it was known that rationing was to be practised the applicants always exaggerated their real requirements so that their actual allotment done on a *pro rata* basis might come up to their real requirements. That was how deception was practised. It is part of human nature to resort to subterfuges, good, bad or indifferent, when individual liberty is cut down.

Thirdly, the Imperial Bank of India has been placed in a position to control the exchange operations. It would thereby enable it to learn the technique of the exchange operations and make it fit to transact exchange operations on a wide scale as soon as it is deprived of the semi-Central banking operations it is conducting to-day. It has become an open secret now that it is casting covetous eyes on the field of foreign exchange and the present-day experience would enable it to easily tack on general foreign exchange business as soon as the C. R. Bank is started.

Fourthly, the absence of a stable domestic exchange banking machinery is deplorable. The Bank of England was never controlling the exchange operations even in times of this dire economic emergency The heads of the foreign exchange departments of the Big Five are performing this duty and beyond the appeal to patriotism of the British public not to depreciate the pound sterling no interference with the day-to-day administration of the exchange banking machinery has been brought about.

Fifthly, the necessity of publishing with utmost possible expedition the figures of the sale of sterling and the details of the adequate machinery which has enabled the Indian Government to secure the support of His Majesty's Government for securing sterling resources has to be realised. There is indeed one danger which the publicity of this arrangement might bring about. The depletion of the sterling credit resources will

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[1] *See* Mr. Macdonald's Evidence referred to in Mr. Manu Subedar's Minority Report—C.B. Enquiry Committee Report, p. 284.

accentuate the difficulties but as psychological or speculative factors are removed by exchange control it will provide a natural limit to their influence.

Sixthly, the additional bounty which depreciated sterling would confer on British exports would be of little avail so far as the Indian market is concerned. The manner in which it has been secured has alienated the sympathies of all well-meaning citizens. The continuance of strained feelings arising out of domestic political situation would be a grave handicap. The fixed wage-earning class and the salaried people who generally consume the British manufactured goods are already feeling the pinch as a result of the depreciation of the internal value of the rupee. They would fain be able to increase their demand for either the imported British goods or those of other gold standard countries. The future budgetary position of the Government of India would become rather grave in spite of present-day balancing measures. This would entail further taxation which would restrict the ability of the Indian consumers to purchase foreign goods.

Seventhly, the additional bounty which depreciated rupee gives to the Indian exporters in the matter of transactions with gold standard countries has been grossly exaggerated. Because 76 per cent. of our trade is with gold standard countries this temporary stimulus would be secured. India exports mostly the raw materials of commerce and agricultural staples. These have been unfortunately overproduced in most countries of the world. Indian wheat can find no world market. Rice can find no Eastern markets till an export credits scheme or some other device will enable China and the Eastern markets to demand it. Indian cotton will find it difficult to secure a market in face of the huge output of the U. S. A. cotton, part of which was bartered for so much coffee of Brazil. So an immediate improvement of export trade except in the case of those goods where India has a *quasi*-monopolistic control

cannot be expected. Taking jute which can be reckoned under this category, the demand for it would be slack till the present overstocking of the foreign markets disappears. An all-round stimulus to external trade can hardly be expected when the foreign consumers lack the effective demand for our goods. Internal commodity prices have risen already as a result of the depreciation of the rupee but permanent easier export trade conditions cannot ensue out of this step. A depreciated rupee means " the real values of salaries, wages, interest payments and debts will all be reduced ". It is not national but class prosperity that is ensuing out of this step. There can be no real national wealth arising out of it.

Nextly, the artificial support of the sterling rupee at the high level of 18*d.* is to give scope to transfer of the sterling investments made in the country without any possible loss which might arise were sterling to fall to a lower figure. It is the holders of sterling that ought to have borne the exchange loss. Equity demands that the rich investor should bear all risks attendant on the transfer of repaid capital and interest but it is being thrust on the poorly equipped borrowers. India's financial independence would mean no longer preferential conditions to external investors. But mere safety is not however endangered thereby.

Ninthly, the flight of gold and capital from the country would take place to countries where political, social and credit conditions are more secure and free from attendant risks of currency depreciation and political uncertainty. A continued retrogression of the rupee would mean a further stimulus for the flight of capital. The export of gold is taking place mainly in order to take advantage of the insistent demand in European and English markets. So long as the price of gold is below dollar parity this movement will continue. An embargo on gold and the acquisition of gold at the import point of sterling-rupee exchange, *viz.*, 1*s.*-$6\frac{1}{1}\frac{3}{6}$*d.* by the expanding of currency would kill two birds at one shot. The gold resources would

expand and internal prices would have the needed fillip. But the maintenance of high exchange value for the rupee would become impossible under such conditions.

Again the British Government's financial support to enable it to discharge the India Government's ratio obligations stand unrescinded. But in view of its own inability to secure substantial credits from abroad the promise of a weak borrower is rarely a convincing and reassuring one. But these long-term credits could at the same time be arranged by a financial mission sent to New York and the linking of the rupee to gold at the present-day ratio of 1*s*. 6*d*. gold, would mean the continuance of the *status quo*. The possibility of paying sterling obligations indirectly through the dollar credits would add to the embarrassment of the sterling situation. Further depreciation of sterling would ensue as a result of India's efforts to pay sterling indebtedness through the gold markets.

Again, this episode of linking the rupee to the sterling clearly shows that the stability of the rupee sterling exchange is the only dominant consideration of the Government of India. It does not appear as a custodian of the general public interests when it undertakes to supply the machinery which would enable the merchants or remitters to cover their risks. The Exchange Banks are the instruments whose intimate touch with trade will enable them to shoulder this risk.

The next point of criticism against the new Ordinance is the promise to give gold also or sterling provided the amount demanded is through the scheduled bank for the minimum amount and satisfies the regulatory authority that it is a *bona fide* demand for exportation purposes in lieu of discharge of past contractual obligations or for definite domestic purpose requirements of the remitters. It is one-sided stability that is now being enforced as a result of the Ordinance. It is the reverse draft at 1*s*. 5 $\frac{3}{4}$*d*. that is available. Domestic currency is not being released even at 1*s*. 6 and 3/16*d*. sterling

ratio. The refusal to take gold and release currency at this import point means that the par points are not fully operative.[1]

CAN WE INTERNATIONALISE THE GOLD STANDARD ?

If the energy of Great Britain were to fructify in the formation of an all-World Conference for stabilising the position of gold and bring about a satisfactory adjustment of gold holdings good cometh out of evil. It must be a public international conference at which the respective claims of Central Banks to increase the gold reserve would be examined by a body of experts. But we must not commit the mistake of going to the unrestricted gold standard suddenly or too soon nor enforce an overvalued rupee and an onerous exchange ratio. Unless and until the world economic crisis were to be effectively tackled there would be no possibility in attaining stable trade and exchange conditions. Resort to the post-war gold standard would only mean the prospects of early suspension. Without internal monetary use of gold a scientific gold standard involving intelligent management can be made to work.

WHAT OF THE IMMEDIATE FUTURE ?

If the above findings clearly indicate that a restoration of the international gold standard can take place in the remote future alone what has India to do in the meantime ? Till the expiry of the Ordinance period the rupee stands linked to the sterling. But at the end of this period the rupee should be declared an independent currency neither linked to sterling nor the gold whose future is on the laps of gods alone. Before discussing the ratio at which it ought to be linked if the international gold standard were to be adopted the consequences of the adoption of an independent rupee standard have to be understood. An independent rupee carefully regulated would

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[1] Since these lines were written the Government have been purchasing sterling at 1*s*. 6 and 3/16*d*. Hence a *de facto* stability of the rupee is to be had at present.

not cause any embarrassment to the gold reserves of the country. The Finance Member's argument that " if the Rupee was not linked to sterling the difficulties of India Government to raise money abroad would be almost insuperable " needs refutation. He is repeating afresh the old argument of the British capitalists who wanted steady sterling-rupee exchange in the days of the past nineties. The ability to raise credits abroad depends upon the financial ability of the Government. A financially unstable Government like Australia's was refused a loan either in America or England though it was on the gold standard. If the Government of India were to follow the proverbial rake's progress it is not external credits alone that would be denied but even the more thoughtful of the domestic creditors would think twice in granting the needed resources. Granted that America does not play fairly the game of a creditor an appeal to the newly started Bank of International Settlements [1] will have to be made through the C. R. Bank.

Under an independent rupee standard India will not find it difficult to raise the necessary sterling resources to pay the annual 32 mil. liability and pay off any other maturing sterling loan obligations of the Government. It is almost a truism to assert that a country should have command over other countries' currencies with which it trades. Although India has trading relations with most of the important countries of the world she needs command over four major currencies in order to discharge her obligations. Sterling, the dollar, the guilder and the yen are the important currencies needed by this country. The sterling requirements of India predominate over other currency requirements. It is the realisation of this fact that makes the people say that sterling requirements ought to be secured at a fixed and stable ratio in terms of the rupee. A stable sterling value of the rupee does not mean that sterling values of other countries' currencies can be stabilised. The

[1] *See* Dr. O. W. Sprague's paper, " The Working of the Gold Standard ".

trade with gold standard countries would be disturbed on account of the fluctuating value of the sterling in these currencies.

UNSTABLE STERLING.

Granted that linking with sterling in normal times when sterling is equivalent to gold is an advantage, it does not follow that the rupee ought to be linked to inconvertible sterling. Even a rat deserts a sinking ship almost instinctively. If it were mere disassociation with gold that is the main weakness of sterling there is nothing inherently defective in such a position. But there is no definite assurance that the sterling will not follow the path of the franc of 1921-1928 or that of the mark of 1921-1925. Were the Labour Government to be returned to power and were they to persist in the policy of adding outlays of unproductive character in spite of deficit budgets and threaten to carry out class legislation, there would be no knowing where the pound sterling would be standing. Its future is uncertain as there is impairment of confidence as a result of the absence of economy in Britain's national expenditure.[1] An inconvertible currency like the paper pound sterling can be easily subjected to the influence of the petty national politicians. It is an elementary economic truth which says that an inflated currency would be entirely valueless and afraid of further taxation measures the political party in power might bring about perpetual interference with domestic currency values. Unless and until this assurance is also given that no inflationary influence will be exerted on paper currency the Government of India ought not to have agreed to link the rupee with the fluctuating sterling.

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[1] See Sir George May Committee Report. This famous Economy Report explains the National Crisis in England. It points out the urgent necessity of balancing the budget and making it of smaller dimension than before. The central wealth fund of the Nation must increase before national solvency will become an accomplished fact.

India not a mere Debtor Country but a Debtor-Creditor Country.

Too much capital is being made by the advocates of exchange stabilisation policy of the fact that India is a debtor country. Correctly speaking, India at present is on the debtor-creditor basis. The Memorandum on the Balances of Payments points out that no net claims are being built by India on the other countries of the world. If it were a real creditor country the net claims it builds on other countries would be increasing. When as a whole we find overselves in a transition stage as it were, this insistence that sterling and sterling alone will help us is meaningless.

We can maintain an economical and efficient internal currency which is at the same time suited to the requirements of the people. Its external value would depend not only on its internal value but in times of international instability in foreign currencies the changing value of foreign currencies would have its own repercussion on the value of the domestic currency. The domestic banking system should be able to understand the influences and facilitate the matter of transition from the debtor to the creditor status.

The Immediate Issue.

India's main trouble as in the case of most other countries lies in the greater fall of agricultural prices than that of the manufactured commodities used by it. This problem can be attacked in two ways. Either the prices of manufactured commodities can be pushed down or the prices of agricultural staples have to be raised. As periods of slowly rising prices secure economic relief to almost all sections of society it is this ideal that is being advocated as a desirable remedy in all countries. A modest watering and not an inflationary issue of currency would be required to bring about such a rise in commodity prices.

The recent very considerable developments of the heavy general tariff that are being brought about would not fail to produce a rise in the normal rate of exchange. The currency authorities should pay heed to these changes in the tariff while fixing the rate of exchange in the near future.

It is an immediate rise in prices that is needed rather than the securing of the ideal exchange rate of pre-war times without *any* rise in prices. A modest rise in prices and a stabilisation of the internal level of prices at that point is the crying need of the hour. While allowing exchanges to go hang, the attention of the Government can be concentrated on the stability of the internal prices so long as international prices tend to be unstable. This policy ought to be our aim as soon as the present Ordinance expires. It is the level of prices that matters and not exchange rates. Linked neither to gold nor sterling the rupee can be made to possess a stable internal value as it did during 1919-1921 period so that the entire business interests of the country stand to gain out of this step. This policy of internal price stability would help us in the contingency of the sterling becoming stable for it will secure a stable ratio for the rupee in terms of sterling.

Is America redistributing Gold ?

The period of redistribution of American gold stock which was impeded by the Stock market boom of 1927-29 seems to have commenced afresh. American gold is being shipped to France, Switzerland and Holland. The shortage of gold in other countries can be directly attacked and the economic allegiance of these countries to the gold bullion standard can be secured thereby. India should be represented at the World Economic Conference which would discuss the future of the international gold bullion standard. On the solemn and distinct promise of not using the gold stock for gold currency we should secure American or French gold and help the broadening of the international gold bullion standard. But nothing

would be more important than to suppress the inborn predilections of the people for imports of precious metals and for unproductive hoarding in the jewellery form.

If America and France were to refuse to part with their gold stocks the idea of the Bank of International Settlements managing the gold reserves of the world in such a way as to maintain reasonable stability in the international price-level may and should be exploited.

But if this suggestion is not feasible there would be the truimph of the anti-metallist ideal, *i.e.*, managed currency with the special object of maximising stability of prices and exchanges at a minimum social cost. By pursuing the domestic policy of internal price stabilisation during these days India can blaze the trail of general monetary policy and reconstruction.

A Possible Contingency.

As soon as sterling rises to its gold parity, for every one in England who has studied the Macmillan Report is convinced of the futility of devaluating sterling as a remedy to the present crisis, attempts will be made to stabilise the rupee in terms of sterling which has reached parity with gold. The present-day sterling exchange standard ushered in by the Ordinance would give way for the *de jure* gold bullion standard which however would be worked in the manner in which a *de facto* gold exchange standard would be working. The legal fiction of gold standard would again be spun but in administrative practice it would tend to degenerate to that of a gold exchange standard. Unless and until it is a form of the improved gold exchange standard almost coming up to the "ideal gold exchange standard" of the economist's conception, the Indian public should emphatically protest against its adoption. It should be the duty of the Currency League to educate the public by issuing small leaflets on the different standards—their merits and demerits and their suitability to this country. The working of the improved gold exchange standard would bring about the

expanding of the currency of the gold exchange receiving country and tend to contract the currency of the other country.[1] But as the Hilton Young Commission has wisely stated, the Indian public cannot find the gold exchange standard mechanism easy to understand and simple to operate.[2] It does not secure the internal convertibility of the token currency into metallic gold. Any future currency system for this country must give this right and must be worked on this definite understanding. The real gold bullion standard gives this right and, as Dr. L. J. A. Trip admits, the gold bullion standard system has met no criticism.[3]

How can India achieve the Real Gold Bullion Standard System ?

This can be done by starting the Central Reserve Bank. This C. R. Bank should be provided with the necessary foreign exchange assets in sterling, dollars, guilders and yen and a gold reserve to cover its notes and sight liabilities. With the return of more settled conditions in the international money markets than are existing at present the exchange should be stabilised at round about the normal level at which it stands at the inauguration of the C. R. Bonk and the collection of the proceeds of the external loan. As a low exchange would have an adverse effect on our external debt the monetary experts should be careful in fixing the exchange value of the rupee. But it ought to be done on the basis of rate discovered to be normal as a result of allowing it to move freely up and down for some considerable length of time.

A New Monetary Phase.

The Indian monetary system would then be entering another phase of its career. Confidence in the future of India

[1] See the paper entitled "The Reform of the Gold Exchange Standard." Select Documents of the Gold Delegation Committee of the L. of N.

[2] *See* Hilton-Young Commission Report, pp. 24-32.

[3] *See* Dr. L. J. A. Trip, Paper entitled "The functioning of the Gold Standard."

would largely depend on the belief both in India and outside in the stability and efficiency of the monetary system. Many people are not aware that the Indian Government cannot arrange any external loan without the sanction of the British Parliament. Genuine efforts should be made to induce the British Parliament to grant us this power. With an assured budgetary equilibrium and an unproductive debt which is very small there is no reason why American financiers would fight shy of financing us. If the loan proceeds were not to be locked up in barren gold currency units there can be no economic reason for the refusal.

Attempts should be made to garner more gold resources for an efficient working of the gold bullion standard by the C. R. Banking machinery which needs at least 80 to 100 ms. worth of gold.

Armed with the necessary resources the C. R. Bank can, by the pursuit of the well-known foreign exchange methods secure the stability of the external value of the domestic currency. The sales and purchases of both the domestic currency and foreign currency, the perfection of the forward exchange market and the varying of the buying price of gold would enable it to steady and regulate the external or the exchange value of the rupee. There would be no failure on its part to stabilise the normal rate of exchange which ultimately depends on the relative price-levels of the countries.

CONCLUSION.

The logical outcome of above trend of reasoning would compel one to admit that stabilisation of exchange at any level of sterling exchange or gold exchange would be premature when there is no prospect of relative stability in international prices. Relative instability of international prices, viz., rising prices in agricultural countries and falling prices in the gold standard countries, would mark the course of our economic events. If a conjoint effort is made to secure rising world prices and avoid all rapid fluctuations altogether the time would arrive when

we can no longer allow exchange to take its own course. But the very adoption of the international gold bullion standard form by this country will give the substantial measure of relative stability of prices and exchanges and a close correspondence of local currency policy with that of the rest of the world. International prices, internal prices, and exchange rates will all be under control. India would have to wait for this day of internationalising of the gold bullion standard pursuing during the interregnum a policy of masterly inactivity in the direction of securing practical stability of exchange. Let exchanges be used as the shock-absorber. Let us not ignore the possibility of raising the international price-level by the united efforts of all countries. Let us consummate our best energies in bringing about a modest rise in the present-day world prices.

APPENDIX II(A).

The advantages of linking the rupee to inconvertible sterling at 1*s.* 6*d.* ratio are as follows:—

1. There would be an exchange bounty on Indian exports to other gold standard couutries. As India's trade is more with gold standard countries than England there is a temporary stimulus at least as a result of this exchange bounty on Indian exports to these countries.

2. The Government of India will not lose anything in the payment of sterling obligations. If a fall in the rupee-sterling exchange value would take place it would increase the amount of rupees to be laid aside to pay the sterling obligations. Without stable sterling-rupee exchange the Indian budget would become a gamble in exchange.

3. Without linking to sterling the gold value of the rupee would fall to a very great extent.

4. The Indian market is secured to British exports as against the competition of manufactures of the gold standard countries. This tantamounts to giving Imperial Preference by back door methods.

5. An element of uncertainty in the trading relations with England which amounts to twenty-five per cent. of our total trade would be removed. The remitters also stand to gain by stable rupee-sterling exchange at 1*s.* 6*d.*

6. The rupee will depreciate, *i e.*, the internal value of the rupee falls, *viz.*, prices of commodities will be rising.

7. The frantic attempts on the part of the Government to support 1*s.* 6*d.* gold value for the rupee would cease.

The disadvantages have to be considered—

1. Indian import trade with gold standard countries becomes impeded. As goods pay for goods the Indian exports will become ultimately restricted.

2. The changing of the currency standard is a violent breach of national faith. The gold standard countries are justified in considering this step as the betrayal of national trust.

3. This gives an excellent opportunity to secure long-term credits and pay off sterling obligations out of the funds for sterling has become depreciated in terms of gold. This attempt to pay off sterling debts as the result of concerted action would tend to depreciate sterling further. The real sacrifice to pay external debts would still have to be made by this country.

4. There would be the flight of capital for there is lack of confidence in the rupee and the Indian monetary system.

5. It is a sad mistake to maintain the standard of value with the incidental and varying circumstances of exchange.

6. Unless an embargo on gold is placed India would be drained of all its gold stocks.

7. It places India at the mercy of currency and credit changes in England. This monetary subordination to the foreign centre turns out to be misplaced reliance in the long run as soon as sterling depreciates further and further.

Although the advantages of linking the rupee to sterling have been widely discussed much emphasis has not been laid on the consequences resulting out of linking the rupee to gold.

1. Trade with gold standard countries would not become handicapped if the rupee's gold value does not become altered. No uncertainties in trade matters with these gold standard countries would arise.

2. The rupee might not depreciate in terms of gold if left to itself. It is inability to discharge gold obligations that might bring about this contingency. But there is not much need for great credit amounts to pay off the gold obligations.

3. Unless a solid link to gold metal is established the Indian public will have no faith in the currency standard by whatever name it goes in academic discussions. There is nothing so dangerous as lack of confidence in the currency standard. The flight from the rupee would take place when the people think that the rupee is doomed.

4. If the gold rupee were to rise in terms of sterling there would be exchange gain. Sterling obligations can be paid with lesser number of gold rupees.

5. Remitters also stand to gain if the gold rupee were to appreciate in terms of sterling.

6. When sterling rises to its gold parity the rupee-sterling exchange can be stabilised once again.

7. Stable exchange between England and India does not mean stable international commerce for India trades with the other countries of the world.

The disadvantages of linking with gold would be as follows:

1. Inability to discharge gold obligations will tend to depreciate the gold value of the rupee.

2. If there were to be no immediate depreciation of the rupee the exchange bounty to Indian exporters will disappear.

3. Prices of commodities would not have arisen if the *status quo* had been maintained by linking the rupee to gold at the present ratio of 1*s.* 6*d.* gold.

4. If 1*s.* 6*d.* gold value for the rupee could not be maintained during 1929-30 it means that the rupee's real gold value is high and has to be depreciated.

5. There would be the draining away of the last ounce of gold from India if it were to bolster up an onerous ratio of 1*s.* 6*d.* gold for the rupee.

6. The Imperial Preference to the British exporters will still exist in this case for the sterling stands depreciated in terms of gold. Exchange dumping from England would still exist.

7. India would have no credit if the rupee is not linked to sterling.

If exchange were allowed to go adrift, *i.e.*, if the rupee is neither linked to gold nor sterling there would be the possible advantages and disadvantages arising out of this step.

Advantages would be as follows :—

1. The dangers of tying ourselves to inconvertible sterling currency would be removed. It would fall or rise to the normal level and get steadied according to the relative price-levels of the trading countries.

2. Exporters and importers would attempt to shift the risk of fluctuating exchange levels to exchange dealers who will make a genuine attempt to balance the gains and losses. Forward contracts with Exchange Banks can eliminate these risks.

3. Stability of exchange is an international task and when so many countries are off the gold standard an era of unstable currencies and a wilderness of exchange rates would ensue. Our exchange stability would become impossible under such economic conditions.

4. There might be no frittering away of resources. What might be lost in maintaining the gold value for the rupee might be compensated out of the gain arising in the direction of maintaining the rupee-sterling exchange.

5. Trade can flourish even in days of exchange instability as it did in 1872-1892 and 1921-1925.

6. It would be free from the charge of official manipulation of internal prices for the maintenance of an impossible ratio of exchange.

7. A policy of relatively stable internal prices giving uniform purchasing power for all classes can be pursued and exchange allowed to follow its own course.

The disadvantages are as follows:

1. Currency experts, realising the tendency of gold output to be smaller than world's monetary requirements have been foreshadowing a fall in prices. Under this contingency the maintenance of 1*s.* 6*d.* gold value for the rupee would be impossible. Sir Basil Blackett's gamble in rising prices proved a failure. Devaluation is inevitable. This policy of exchange instability arising under this contingency would add to the troublous situation.

2. Present business disturbance and economic depression would be heightened by exchange instability.

3. It would be enlightened selfishness and not mere philanthropy even towards England if we fail to accept the verdict of the Secretary of State in linking the rupee to sterling.

4. It will not check the flight of capital but nothing can check this tendency for capital like water tends to find its own level.

5. There is a sterling loan maturing in January 1932. It would be impossible to pay this without the necessary external credit or supply of gold credits.

B. Ramachandra Rau.

APPENDIX III

SOME SALIENT LESSONS FROM THE FOREIGN BANKING SYSTEMS AND THEIR APPLICATION TO INDIA PROPER.*

SUMMARY.

In this essay are set forth some of the salient lessons that this country can hope to learn from some recent happenings in the foreign banking systems. With the problem of starting the Central Reserve Bank in the foreground of the banking reconstruction plan, certain other lessons which ought to be borne in mind are pointed out. There can be no overhauling of the banking structure without the creation of the Central Reserve Bank. An elastic system of rural credit and proper specialisation in the field of credit must be some of the important aims of the banking reformer who seeks to overhaul the banking structure. A banking system without the C. R. Bank is like Hamlet without the ghost. But an erroneous start in the organisation or the working of the credit policy or the aims of the C. R. Bank would taint and pervert the whole of the banking system. The difficulties in its path must be overcome by skilful banking practice and it will not take a long time to appreciate the usefulness of the C. R. Bank. Its immediate achievements might not be very tempting and its immediate success might not be assured, but by patience and perseverance alone can the Reserve Bank evolve into a useful organisation, as safe and steady as the Bank of England itself, and maintain the currency and finance of our country in a state of stability.

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* A paper submitted to the Indian Economic Conference and this was published in the *Indian Journal of Economics*, Jany. 1931.

The Connotation of the Term "Bank."

Surveying banking institutions from Japan to England, we discover that banking business is not the same everywhere nor is it so static and fixed as some of the observers of the banking systems are apt to consider. Banking business is of slow evolutionary growth. While the word "Bank" has received an extensive and wide connotation on the European Continent and Japan, the modern English Bankers still pin their faith to the conservative and old-fashioned idea that "banks should provide money and not capital." This, at any rate, is the bounden duty of the commercial banks. But a society requires other types of banking institutions to complete the financial machinery which its manifold activities require. Until now Indian banks have been slavishly following the English Banker's conception of his duty. Nothing is more important than to fill the gap in the monetary field arising out of the banks confining themselves to commercial banking alone.[1] Either a change in the conception or an extension of the connotation of the word "Bank" is essential. Mere extension of the duties of the commercial bank without due precautions is dangerous. Some of the co-operative credit societies who have combined the granting of long-term loans along with short-term loans have found out much to their chagrin that the cultivators required long-term loans alone, even for *bona fide* short-term needs. When the mentality of the Indian borrower is such, it is inadvisable to allow one and the same credit institution to perform both the purposes, *viz.*, the provision of loans for short as well as long-term purposes, however cautiously it might propose to

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[1] Specialisation has extended so far in the U.S.A. that we meet with banks started solely for financing certain industries alone. Quite recently the Continental Bank of New York decided to increase its capital and finance the broker's requirements and thus pave the way towards stabilising call money rates and the collateral loan market rates. About 350 stock exchange and curb houses hold the stock and the directors are all representatives of the brokerage houses.

conduct these operations. An elastic rural credit system both for short as well as intermediate and long-term purposes would be essential to complete our banking structure. Every banking system, including the English banking system, has now made systematic provision for elaborate long-term provision of capital to agriculture and industries. India, being predominantly an agricultural country, cannot afford to postpone the adoption of this essential and useful feature.

A Central Bank of Issue.

Excepting Canada, where a Central Bank of Issue does not exist, all important banking systems have a Central Bank of Issue acting as the guide, friend and philosopher of credit institutions. Whether designed as a pure Central Bank or allowed to act as a Commercial-cum-Central Bank, the main duties of the Central Bank are to gather a big monetary pool, pursue resolute monetary control and bring about expansion and contraction of credit so as to maintain healthy conditions conducive to the prosperity of the traders and the general public. Admirably fitting itself into the gold standard monetary organisation it controls the gold movements into and out of the country and protects the gold standard system from the evil influences arising out of a gold efflux or influx.

So far as the general features of these Central Banks are concerned they are the depository of the reserves of the other banks and the reserves of the Government. They are custodians of the national gold stock and the supervisory monetary policy is greatly facilitated by this watch and ward over the entire gold resources of the nation. Acting as the Government Banks they manage the public debt, make disbursements on behalf of the Government and lend money to it within limits laid down by the legislatures of those countries. The discharge of these duties confers prestige and undoubtedly adds to their earning capacity.

A survey of their actual operations would enable one to realise that there are three types of Central Banks. The Continental type as typified by pre-war German and French Central Banks which conducted private business in competition with the commercial banks. Both the Reichsbank and the Bank of France performed these banking operations in several places and they acted as banks of deposit, discount and issue to the general public as well as the banking institutions.

Opposed to the above mixed type of Central Bank stand the modern Federal Reserve Banking System and other Central Banks created after its model. The pure Central Banks as they are often designated regulate credit and currency and rediscount for member banks alone and do nothing else. They have business dealings with the Central Banks of other countries.

Midway between the two types stands the Bank of England. It regulates credit and currency and mobilises the national gold stock in its hands. It has important private business of its own not only with the Central Banks of other countries but with the general public, the Government and the commercial banks. Through the bill-brokers it carries on its expansive and contractive side of its operations. Its open market sales and purchases of securities make the bank rate effective. All these types of Central Banks have one comprehensive programme of social utility and they propose to achieve this by altering the discount rate and trying to exercise through it, certain amount of influence on the price-level and the stabilisation of the business life of the country. Discarding the old gold basis as the sole regulator of their discount rates they are using varied economic data to regulate their credit policy and this new orientation of their credit policy is such that it forces even the pure Central Banks to enter the money market and by means of their "open market operations," *i.e.*, by buying and selling securties they

attempt to establish a close touch with the country's credit conditions and secure effective control of the money market. Almost all the Central Banks realise that they are not " mere dividend-paying machines, but nobler and higher instruments endowed with altruistic motives which inspire them to perform the sacred task of regulating credit and currency and managing the gold standard in the wider interests of the country." The aim of earning dividends for the shareholders has everywhere been subordinated. As Governor Strong of the F. R. Bank of New York says, " Earnings are not an influence in fixing the credit policy" of the F. R. Banks. Such an enlightened ideal governs the actions of the different Central Banks. Though Commercial-cum-Central Banking is pursued, the substantial duties and operations with the public do not go much further than the one of earning its own expenses and securing a mere reasonable profit to its shareholders. Another cardinal function of the different Central Banks is "to save the public at the right moment from the ruin which might result from the blunders of the private banks." So far as ordinary duties are concerned " the Central Bank performs the same benefit for the daily traffic in the banking world that the pneumatic tyre does for the motor car. It cushions the bumps and makes the whole service easier, smoother, speedier and more efficient."[2]

While the above are the functions of a Central Bank and the performance of which would entitle any bank to be considered as a Central Bank, there is now much uncertainty as to the proper manner in which the Central Bank has to be organised and managed. When even private Joint Stock Companies consider it important to maintain national control and not allow themselves to be managed by foreign investors, there ought to be some hesitation in an economically undeveloped country in the matter of organising a shareholder's

[2] *See* Governor W. H. Clegg's article on " Central Banking in South Africa," *Economic Journal*, December 1929, p. 532.

type of the Central Reserve Bank.[3] The limitation of voting rights to nationals and national corporations and discarding foreigners as directors unless approved by the majority of the Board are some of the methods pursued to eliminate the undesirable influence of alien shareholders. Another useful move is that of the Marconi International Marine. It consists in setting aside the "foreign share" separately and allowing the foreign shareholder no privilege to hold the "national share" while the national shareholder can own the share even in the "foreign register."

The recent American invasion to secure control over British companies is being openly resented and several of them like the General Electric Company, are not allowing the foreigner to acquire the majority of the shares so as to secure control over its policy.[4] When the Central Bank has to discharge important national duties there is no reason why foreigners should be allowed to have the controlling voice.

To eliminate all such undesirable influences, the method of starting a Central Bank by issuing public debentures guaranteed by the Government gives a convenient handle. Though the idea of a mixed State Bank is thoroughly familiar to the Indian public, yet it introduces or gives scope to the Government to exercise political pressure on the Bank. Considering the fact that throughout the world the executives of the Central Banks are being made free from political pressure and independent enough to pursue national policies, there is no wisdom in hankering after the old and almost forgotten ideal

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[3] A more thorough statement as regards the advisability of the particular type or organisation of a Central Bank will be found in my Present-Day Banking in India, Chapter on the Central Bank of Issue.

[4] The Imperial Airways Co. of the United Kingdom excludes totally all foreigners from holding shares. *See* also the Literary Digest which says that "one after another of the British Companies whose securities have been made active by American buying are meeting hastily and amending their charters or bylaws to provide that control can never go overseas and that a majority and frequently all of the directors of the Corporation must be born British subjects." March 30, 1929.

of a mixed State Bank. If the shareholders' type of a Central Bank is undesirable for, without a clause which introduces racial discrimination the restriction over foreign control cannot be exercised, it has to be given up. The State-owned and State-managed Bank, being also undesirable, it easily follows that a stockholders' bank would free it from all dangers arising out of a defective constitutional organisation of the Bank.

All Central Banks display an international mentality and a rapid development of this needed mentality cannot be engendered by a purely State-owned or mixed State Bank or a Shareholders' Bank. A stockholders' bank under the capable guidance of experienced bank officers would easily develop this mentality and stand ready to co-operate with the executives of other countries and bring about the international financial community of interests. The idea of world peace can thus be better established indirectly by this method than by any other direct move such as the proposals for disarmament of navy, army, etc. It leads to a disarmament of the mind and is bound to succeed.

THE CASH RESERVE OF THE CENTRAL BANK.

War-time and post-war experience shows us that the reserve of a Central Bank can be far lower than the legal reserves when no gold is seriously intended for internal circulation. Gold is now intended for mere export purposes and the national gold stock that ought to lie in the hands of a Central Bank should depend purely on the balance of payments. As gold will be called upon to pay the unfavourable balance, it ought to bear a proper relationship to this alone. But in actual practice all Central Banks fix a relationship between notes and deposit liabilities which are "unrelated and this is clearly meaningless" says J. P. Colbert.[5] Both the fiduciary and proportional reserve systems are meaningless as

[5] *See the Statist*, Jubilee No. 1928, p. 39.

applied to the Central Bank. A low proportional reserve or a high maximum for fiduciary reserve is essential to give elasticity to the note-issue. Any other legal reserve regulation would be stringent and would heighten the demand for gold on the part of the Central Banks of the world. A falling supply of the world's gold stock would result in bringing about deflation. Gold would tend to become exalted as the master, instead of being treated, deservedly, as the servant of mankind. To reduce and remove altogether such undesirable consequences the gold reserves ought to bear a fixed proportion say a fixed multiple of the volume of trade and if this proposed idea underlying the Central Bank's reserve were to be accepted the international gold centres have to maintain higher stocks of gold than the above so that this free margin of gold would allow them to play the rôle of international financial centres.

Though the rational basis of the above suggestion can be easily understood no nation has adopted this principle in the formulation of the cash reserve basis of the Central Bank.[6]

Elasticity of note-issue without the danger of monetary inflation is the cardinal basis on which the note-issue privileges of a Central Bank are formulated. The fixed fiduciary principle now recognises the advisability of fixing this limit at as high a maximum as possible so as to cover all seasonal requirements without any alterations in the law. The expansion of this note-issue limit at times of panic is permitted and a periodic revision of the note-issue limit is also desirable to satisfy the changing requirements of the people. This is what the cumulative experience of France and England teaches us. All nations condemn any deflationary tendency underlying the note-issues when the trade demand is growing.

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[6] Even our Gold Standard Reserve meant for stabilising the G. S. System is not based on this principle. It was discussed as the only safe basis for the fixing of the amount of the G. S. Reserve but was given up. Only £40 millions are now held in the G. S. Reserve.

They are equally emphatic in their declaration for checking any inflationary tendency which can be brought about by the issue of excessive bank notes. This is the reason why all countries which have adopted the proportional method of note-issue have carefully defined the nature of the assets which can give rise to the notes. They have jealously guarded the legal character of such notes and have promptly arranged for the due retirement of these notes.

This power of safe and elastic note-issue can be properly exercised by the discretionary capacity of the Central Bank's executive. So long as the Government does not create a note-issue of its own nor abuse the right of borrowing freely from the Central Bank of Issue the note-issue can be made safe and elastic at the same time by the wise management of the Central Bank. The war-time experience of the Central Banks amply demonstrates the truth of the above statement. The Bank of England succeeded very well simply because there was non-interference on the part of the State and when this was abused as in France and Germany excessive note-issue became the rule. Dr. T. E. Gregory is essentially right when he remarks that "the Central Bank, which is an organ of economic self-government, implies that the State will neither print paper nor abuse its right of borrowing. As soon as these implications cease to be true, the power of the Central Bank ceases or vanishes."[7]

Though some Central Banks pursued the policy of holding foreign bills freely in the days of currency interregnum, *i.e.* until the gold bullion standard was definitely established, the policy seems to swerve in the direction of strengthening gold reserves and the ultimate aim is to maintain exchanges at par by the use of bullion only, independently of any foreign bill reserve. Both the Central Banks of France and Italy have been pursuing this policy in the latter half of 1928. Too much should not be made out of this arrangement alone

[7] Quoted from the Jubilee Number of the *Statist*, 1928.

and force the Central Bank of Issue of this country to maintain foreign exchange balances alone to settle the balance of payments.

Even England, the classical home of fluctuating bank rates, has adopted quite recently the policy of maintaining a steady bank rate irrespective of the gold stocks held by it. By virtue of pegging arrangements which exist between the bank rate and the deposit rate of interest all money rates become influenced by this policy. The maintenance of this policy stands as a token of its desire to help industrial and business reorganisation so badly needed to enable England to compete effectively with its rivals and maintain its predominant position as the world's greatest exporter of manufactured goods.

All economists admit that the general price-level of a country is susceptible to several forces operating from within the country as well as from without. The supporters of the doctrine of " managed currency " do not propose to straighten out this price-level by means of credit policy alone. The enthusiastic advocates of Central Bank management realise fully " that prices are not a stone wall which is quite immove able but they are not equally wax which gives away to every pressure." They realise full well that the price-level presents a strong resistance to all interference. They are aware of the fact that if undue pressure which is being exercised is increased beyond a certain point it is not the price-level that would decline but the withdrawn currency is replaced by some other less perfect substitute. It may therefore be recognised that the amount of monetary circulation is more feasible of alterations than the price-level itself. Hence the monetary reformers now believe that " it is easier to adapt the quantity of money and credit to a changed price-level than to modify prices by managing the circulation." All this is realised by the advocates of modern monetary reforms. They also believe that the action of the Central Bank should

be timely and however much its influence might be reinforced by other measures, the claim that it would promptly check business organisations from being overpessimistic or unduly pessimistic is not voiced by them. The open market operations might not be very efficacious [8] and the bank rate would fail to carry full sting in the absence of a well-developed bill and short-term money market. It is only in a highly concentrated banking system that the arrangement of a centralised banking machinery would function well. But even there it might be true that a little more competition might be all that might be needed and the rigorous castigations of a Central Bank would not after all be the needed correctives or the panacea for the financial ills of each and every country.[9]

But it must be admitted that a timely action would go a long way in checking abnormal price and business fluctuations that are productive of so many evils to society. Relative stability of the price-level should be the objective of the Central Bank no less than the stability of the money rates.

Without stability in money rates industry cannot hope to flourish even if it were to be blessed with tolerable stability in commodity prices. Higher money rates generally tend to produce uneasiness in the stock market and place hindrance in the free investment of fresh capital. This is the lesson that the recent high money rates of Wall Street teach us (April and May, 1929). These variations in money rates not only tended to make the Stock Market nervous but induced higher money rates all over the world in order to defend their stocks of gold. Even India had to experience a seven per cent. bank rate on account of these higher money rates prevailing abroad.

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8 This is what is realised by the F. R. Board itself during 1928 and many of its officials as well as critics discredit the "managing policy" of the F. R. Board. Officials as well as witnesses before the Select Committee on Banking and Currency admit that credit control is ineffectual and that it cannot stabilise prosperity." *See* the *Statist*, May 19, 1928.

9 *See* A. J. S. Baster, "The Imperial Banks."

Foreign Capital.

The orderly flow of foreign capital through the financial institutions of the country mainly for the purpose of promoting industrial development and other developmental purposes has a favourable bearing on the foreign exchange market. Interest payment and dividend remittances may otherwise operate, but the whole process is an advantageous one tending towards the building up of national wealth. This is the recent experience of Japan, Canada and Germany. There must however,be a limit to the foreign borrowings or else interest charges would mount up to an inconveniently high figure and cannot be balanced through increased exports. Again another disadvantage might arise when the flow of foreign capital from foreign sources might be stopped all of a sudden. Germany had to experience such difficulties in 1928 when the American stream dried up on account of keener demand for speculation on the New York stock market. Germany had to fall back on London and France for securing the needed short-term capital. But when there is international tightening of capital, dependence on foreign capital would be suicidal. Germany realised this situation long ago and almost all countries have been making persistent efforts to develop internal capital markets so as to reduce their dependence on foreign capital. Japan, Canada and Germany are successful examples. Germany, in particular, knows the fact that German economy depends purely on the domestic capital market. The increase in savings deposits of the German depositors is often alluded to as an infallible sign of capital increase on the part of Germany. It is not after all a real sign of economic growth for it depends on higher wages and these reflect on the production costs of industry and capital supply to industry. Although high rates of interest were paid for the domestic loans very few German subscribers were to be found for the loans floated in the year 1928. The situation has improved to a certain extent but dependence on foregin

capital is not given up as yet. The German Banks have attempted not only to accumulate domestic capital but have made it their duty to intelligently co-operate with the creditor countries and secure the needed supply of foreign capital for the domestic borrowers. A prominent German banker says, " Capital is in its very nature international and only elemental occurrences in the political or other spheres can divert it from its natural field of activity. The movement of capital towards Germany can, in the long run, therefore, only be averted by Germany herself, if she pursues an erroneous economic policy, for it is not to be supposed that the atmosphere of international economic understanding, which is apparent to-day throughout the whole world, will entirely be dismissed in the near future."[10]

As British capital is of the type which takes all the risk and all the profit, it is better financial wisdom to lessen our dependence on it. The American capitalists insist on securing a fixed rate of interest. The South American conditions amply prove my statement. No wonder America's capital is increasingly employed in State Railways, public works, etc., and the socialistically inclined States are conducting the public utility services with the help of American capital. The lesson is apparent. We should allow Great Britian to act more as a banker (till the domestic capital market expands) to the Indian industries and less as a workshop supplying us with technical requirements. These would have to be manufactured within this country under Indian industrial ægis. At present banking, insurance, shipping and personal services are being rendered to us for our raw materials and food products. In future banking, shipping and insurance services would be declining as Indian people would be rendering more active service under these heads than before. If Indian domestic capital, which is of late taking some active part in commerce were to pursue this same policy towards industries,

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[10] Quoted from the Report of the Darmstadter Bank.

shipping and insurance the economic self-sufficiency and progress of the country would be facilitated. Like the socialistic States of Argentine and Australia our States should aim at securing foreign capital mainly into the fixed interest-bearing type of investment reassuring the larger share of the profits for the whole community by the State-ownership of public services.

The Internationalisation of Banking.

The major commercial banks in most of the advanced countries of the world are fast tending to become international in character. The internationalisation of banking is being achieved in three ways: (*a*) by extending branches abroad, (*b*) by purchasing shares in foreign banks so as to acquire controlling interests, (*c*) by combining with other banks operating in the foreign area. Though in the pre-war days it was method (*a*) that ruled the circumstances increasing use is being made of methods (*b*) and (*c*) in the war and post-war circumstances. This change in method was due to the anxiety to avoid disturbing the national sentiment of the foreign country and the vested interests of the existing banks whose jealousy and antagonism would soon be roused. Method (*a*) is being openly pursued by the Imperial Banks and the Empire Banks in all those countries where political power and economic penetration cannot be openly resisted by the colonies or undeveloped regions belonging to the Empire. The major Imperial Banks of England, France and Japan have branches in the colonies, spheres of interest and mandated territories. Method (*a*) is now being attempted by the big American banks with a view to get themselves represented in the big financial centres as London, Paris and Berlin so as to be able to afford all-round banking facilities (including tourist traffic) to their customers.

France pioneered the way in adopting method (*c*) and in the Central and Eastern European countries banks were revived by the foreign capital lent by such affiliations. The

resurrection of the Wiemer Bankverien is an instance to illustrate this tendency. Great Britain pursues the self-same tendency and has established the British-Italian Banking Corporation which conducts its business through its allied institution the Banco-Italo-Brittanica. The big five, with the exception of the Midland Bank, have also adopted this procedure.[11]

Indian trade in the Far East can be developed by adopting this method and enrolling the services of foreign banks to help the Indian banks interested in extending the export trade of the country. The big selling units of the major staples should request their banks to bring about such a desirable innovation and the financing portion of their business, the selecting of reliable foreign merchants to act as agents for the sale of goods and a reliable knowledge of the state of credit and domestic circumstances can be secured through such a channel.

Banks and Speculation.

It is oft stated that "John Bull can tolerate anything else except a two-and-half per cent. bank rate." He would fall a prey to speculation during the days of such artificial prosperity. It is part of human nature to forget the lessons of the past. When too great indulgence in optimism and speculative venture is taking place a sharp rise in money rates would be no successful antidote and any manipulation of the bank rate is apt to fail. Danger to business stability would result out of such an injudicious attempt. The exuberant temper of a speculative community will not fail to respond to a sufficient stimulus in the way of cheap and easy money arising out of a glut of savings. The banker's duty is to attempt to deflate speculation, if possible, by drawing a difference between the speculative and the legitimate borrowers, *viz.*, pursue a careful policy of loan rationing. This laudable attempt to supply the

[11] *See* A. J. S. Baster, 'The Imperial Banks,' Last Chapter entitled the Integration Movement.

vital and essential needs of society at the old favourable rates would certainly be defeated by the re-lending of bank credit at higher rates to the speculators or if " outside" money were to be lent to the brokers for speculative purposes.[12] A differentiating and discriminating rate attempting to penalise speculation would not go a long way in checking speculation. The virtue of attempting to protect the innocent and penalise the offender underlies this attempt to ration credit in an intelligent manner. Whether it would succeed in checking speculation or not, it becomes inevitable in some form or other, for an all-round rise of the money rates would only result as the well-known paper the "Economist" puts it, "in penalising the innocent without troubling the guilty." Every other method would be equally futile. Moral persuasion on the part of the Central Bank, its open market operations and differential rediscount rates and the cutting off of foreign bank funds from the money market by the curtailing of private lending in Wall Street by the New York Clearing House have all been tried and found wanting. They proved futile, as the "boot-leg money" placed by the corporations served to stimulate speculation and the cardinal lesson which the recent American speculation crisis so admirably teaches us is that the bank's discount rate is not all-powerful to check the rise in prices or turn an unfavourable exchange rate to a favourable one or restrict the creation of abnormal credit or check speculation which might be engendered by some cause or other. This is what present-day American banking policy teaches us. Speculation has been aptly compared to fever and like fever it must cure itself.

Another grave lesson which the recent wave of speculation in America can teach us is as follows. The American banks

[12] It failed as a result of the influence of the bear congingent, an increase in unemployment and reports of poor earnings for 1927. The raising of the bank rate undoubtedly gave the first blow to the speculation bulls. The high rediscount rates and the credit control policy tended to make the bulls " reel and feel groggy but the knockout blow " came as a result of the above set of circumstances.

suffered greatly on account of embezzlements on the part of the bank officers. The stolen bank money was usually lost by selling short in the bull market. The bank tellers, who were the chief offenders, failed to place funds deposited during the day and the higher executive officials engaged in the same kind of business could not hope to check the actions of the bank tellers.

Quite recently we have come across instances of embezzlement of bank money in our country on the part of the bank officers. Such unfortunate moral delinquencies arise in every country and are solely due to the attempt on the part of the bank officers to live beyond the means of their income or downright dishonesty or speculative gambling with the help of bank's money. Insufficient salaries and the attempt to start outside business in addition to bank duties or other unfortunate hardships generally account for most of the cases of bank embezzlements. The only practicable manner or way of combating this dreaded evil is to appoint responsible officers, only after a thorough investigation of their past history. These can be bound down to furnish sureties. Periodical audits by recognised and capable auditors and the introduction of mechanical appliances to do accounting work would go a long way in eliminating these dangers. Internal audit on financial transactions would be useful and enable one to detect the defalcations early. This is what American banks failed to do and that is why they suffered to such an extent by the huge sums defalcated by the bank clerks. Indian banks ought to understand this much from the recent wave of speculation in the American stock market.

Banks and Publicity.

The Indian banker must give up his attitude of dignified silence. He should no longer be a silent observer of public affairs keeping his pulse on them but it is not mere talking for

public edification that is essential. He should step into the public arena and begin to educate the public by his illuminating addresses on trade, and economic circumstances of the country. The practice of the Bank Chairmen of the "Big Five" has to be emulated. They should not only answer all enlightened or mischievous criticism of their actions but point out the paths by means of which industries can get rid of their difficulties. Besides long and interesting statements of the business of the banks, an intelligent commentary on private economy, public finance and credit and important financial events having world-wide significance should be found in their annual reports.

Similarly, the Central Bank of this country should issue informing balance sheets and now that the 'paragon of conservatism"—the Bank of England which could dare to defy public opinion so long and continue publishing enigmatic balance-sheets for nearly three-quarters of a century has come forward to publish informative balance-sheets, the case for for publicity receives undisputed strength out of its action. The amalgamation of note-issues has proved to be a significant achievement in several directions. The most important thing is the issuing of a bank return supplying additional information. As the right Hon'ble Reginald McKenna says "In the return of the Banking Department the total of the British home bank balances, hitherto undisclosed, is now shown separately as a part of other deposits, while 'other securities' are divided into discounts and advances and securities. These items, as the records increase in length and as experience is gained in their utilisation, will add materially to the value of the statement for short and long term purposes."[13]

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[13] *See*, "A Picture of World Economic Conditions at the Beginning of 1929," p. 103, issued by the National Industrial Conference Board of the U.S.A.

Banks and the Exchange Market.

It has now been recognised in all countries that a forward exchange market is essential for exchange stability. Abnormal methods of controlling exchange rates have been found to be ineffective. The stabilisation of exchange is a thing that tends to establish itself and without such stabilising conditions it is impossible for a long time to restore sound conditions. In the advanced countries the perfection of the forward exchange market had become so complete that it actually dominates the spot rates and in case of the sterling-dollar rates we witness such a phenomenon. The widening of the exchange market, the specialising nature of the exchange brokers and the necessity on the part of the merchants to realise that it is wise to eliminate exchange risks apart from trade risks are the predominant factors in the case of an established forward exchange market.

The financing of foreign trade itself must be done with domestic funds and it is the bounden duty of the Central Banker to indirectly secure this ideal through the intervention of the existing joint-stock banks or those specially created for that purpose. Both the United States of America and Japan, the latter to a less degree than the former, have succeeded in developing suitable banking machinery to finance their own exports or imports with the help of domestic resources.

Banks and the Investment Market.

The perfection of the investment market in almost all advanced countries is a patent fact. America, Japan and Germany stand as outstanding examples of recently organised banking systems where much attention is being paid towards the mobilisation of the domestic capital resources of the country and the investing of the same in safe and remunerative channels by special institutions known as investment trusts and these divide the risks by spreading the investment over a wide area and thereby secure better outturn than

what a single individual, however enlightened he might be in the art of securing safe investments for his capital, can hope to do. The increase of capital is not the main problem but the safety of the existing capital is the sole criterion. Circumstances might force us to borrow in the foreign countries but the rebuilding or renaissance of the domestic investment market must not be forgotten. The creation of an organisation for the mobilising of the domestic capital resources should not be postponed any longer.

Applications of these lessons to India proper.

While some of the salient lessons underlying the discussion have been pointed out already it is essential to frame permanent reconstruction of our banking structure in the light of the most important of the above conclusions. It is assumed that the formation of a Central Reserve Bank and the creation of an elastic rural credit system are indispensable parts of a larger problem, namely, the reform of the entire banking structure. Everywhere else, the bank note-issue, *i.e.*, bank currency forms an integral part of the credit structure. Our plans of banking reconstruction have to be worked out more or less with reference to the plan adopted for the currency reform.

It is difficult to imagine how banking reform can be accomplished without empowering the Central Bank to issue elastic notes which form no meagre part of the total volume of money in the country. Considering the advisability of making bank notes rise or fall in response to the needs of business the first item of our banking reconstruction is to deprive the Government of its control over note-issue. The issue of new notes must be in the hands of a Central Bank. Observing the favourable experience of other foreign countries with asset currency it is essential to issue notes based on the assets of the Central Bank. To ensure confidence in the minds of the public they might be Government-guaranteed.

notes but they must be directly issued by the Central Bank. The asset backing for the notes may be gold and collateral paper such as commercial, agricultural and industrial paper. The proper combination would be 50 per cent. which happens to be the prevailing law in the matter of our paper currency organisation. Having the privilege to issue notes based on gold or commercial paper it can be left to the discretion of the Central Bank to issue notes either on gold or commercial paper as the management thinks it proper to do. The form of eligible paper might be—

1. Notes, drafts, bills of exchange or acceptances issued or drawn for agricultural, commercial or industrial purposes and rediscounted by commercial banks at the hands of the Central Bank.

2. Open market operations or purchases by the Central Bank consisting either of bills of exchange indorsed by a joint stock bank or of banker's acceptances, which at present do not exist to any extent.

3. Notes, drafts, and bills of customers drawn for the purpose of carrying or trading in bonds and notes of the Government of this country or the United Kingdom and rediscounted by the Central Bank.

4. Promissory notes of the commercial banks to run not exceeding three months secured by (*a*) commercial paper eligible for rediscount, or (*b*) Government securities.

Such terms of note-issue which have been outlined above would undoubtedly confer the needed elasticity required by either business or Treasury finance.

To meet sudden emergencies this law can be suspended and additional note-issue can be permitted on the payment of a graduated tax. The discount rate at such times must be made to rise by an amount equal to the tax paid by the Central Bank. Such provisions will satisfy the needs of a crisis or any unusual emergency. Automatic contraction

can also be provided for by the increase of tax and discount rates. By this feature we are incorporating the German and the English devices of creating excess issue to meet emergencies.

The redeeming of these notes at the Central Bank or the Treasury must now be discussed. Both in the pre-war France and the United States of America the Central Bank had the power to pay the notes in gold or silver, as in France, and gold or lawful money, as in the U. S. A. In the future, when gold shortage is to be an accomplished fact, the concentration of gold in the central reserves would be highly useful and a provision of this character would be highly useful in protecting the gold stock in extraordinary times. While this privilege would thus be helpful the question of keeping notes at parity with gold and speedy exchange of notes for gold or gold for notes should not be interfered with in ordinary times.

As the general public of our country do not understand the subtle distinction between legal tender and optional tender it is better to confer the legal tender quality on the notes of the Central Bank. It is undoubtedly true that a proportional note-issue has the possibility of inflationary demand attached to it and to curb this tendency the legal tender privilege for private debts might be denied as has been done in the U. S. A. But even there banks and the government exchange the notes for lawful money at their full face value.

Coming to the actual measures needed for securing automatic retirement of notes which is so essential for contraction purposes, it must be borne in mind that the issue of the One Rupee Note makes it difficult to insure prompt retirement. Large denomination notes would generally float back to the Bank easily but the smaller denomination notes generally are not retired early. The conferring of the legal tender quality would again stand as an impediment to the prompt retirement of the notes. Even banks would be holding these as

part of their legal tender reserves. Although the F. R. notes are not legal tender, yet these are not issued below denominations of five dollars. As inter-district movement and payment of them by another F. R. Bank other than the issuing bank is subject to the penalty of a 10 per cent. tax the feature of automatic redundancy is supposed to be completely effective and to reinforce it special powers are conferred on the F. R. Banks to refuse rediscounts to member banks and compel them to repay old borrowings by returning currency *i.e.*, notes. The F. R. Board has the power to levy interest tax on note-issue backed by non-gold collateral. Next, the rediscount rate may be raised by the F. R. Board, if it finds the note-issue over and above the legitimate demand requirements of business. Lastly, it employs the open market operations on the part of the F. R. Banks to bring pressure and compel the safe retirement of these notes. Thus the chief lesson one has to learn is not to place blind faith in the doctrine that notes find an outlet only when there is legitimate demand for the same and nothing in the direction of enforcing note-retirement is essential. Although notes generally find an outlet through business requirements alone, the necessity to automatically retire these notes as soon as the requirements are satisfied is often overlooked and at such times the Central Banker must be endowed with power to exert pressure on the ordinary banks and secure contraction of the notes. But unfortunately this side of the note-issue provisions, which is meant for contraction purposes, is often neglected. It is not enough to merely lay down regulations checking monetary inflation through note-issue. Just as elasticity should be secured, whatever the state of the gold stock might be, so also the contraction must be managed with a view to save the community from excessive and highly inflationary size or amount of the note-issue. These are the principles on which the note-issue of our Central Bank should be managed and without having an elastic note-issue in its hands which does not at the same time lead to monetary

inflation, satisfactory rediscounting of the eligible and qualified paper would be sometimes impossible and the genuine credit demands might not be satisfactorily complied with.

BANK RATE.

It has already been laid down that a lower and more steady bank rate than the present one should be the ideal aimed at. Considering the last half-year's (ending Dec. 31, 1929) bank rate, the average was 5·788 per cent. as against the previous half-year's average of 5·456 per cent. It would indeed have been higher if trade demand had been felt. Depressed trade and the stagnant industrial situation in the cotton industry of Bombay and the slowly falling prices of country produce needed lesser finance than as usual and there was no borrowing of emergency currency from the Controller of Currency at any time. The seven per cent. bank rate reached in October, 1929 would not have been imposed on the banking system, but for high bank rates ruling abroad and the investment of Indian money abroad. The heavy Treasury Bill borrowings must also have told their tale in this matter and raised the bank rate to seven per cent. One unique feature, however was the low money rate prevailing in the money market in spite of the above advance in the bank rate.[14]

This situation would necessarily have to be changed as soon as the Central Bank assumes charge of the currency and credit policy. This Central Bank should remove the influence of the Government on the bank rate. Any undue raising of the bank rate to eight per cent. as was done by Government pressure would have to be checked. The present-day peaks and valleys of credit fluctuations would be smoothed out as a result of the Central Bank's operations. Its true financial wisdom would enable it to stand prepared for unforeseen,

[14] *See* the Half-yearly Report of the Imperial Bank ending December 31, 1929, published in the *Englishman*, February 3, 1930.

abnormal and unexpected contingencies, though they may be purely non-Indian in origin and character. With the successful financing of the Treasury's requirements by the policy of Ways and Means Advances one reason for unduly pushing the bank rate to a high level would be removed. With an elastic note-issue the seasonal requirements can easily be satisfied at a steady level of the bank rate. Changes in international finance would undoubtedly have a repurcussion on the Indian money market. The best way to meet such abnormal contingencies is to provide the shock-absorber—the Central Bank.

Lacking absolute autonomy and devoid of sufficient resources the Imperial Bank could not withstand any of these extraordinary shocks. Neither the internal situation nor the complications arising out of international financial stringency could be satisfactorily handled by the Imperial Bank. Often when trade demand was acute the cash balances used to reach a low figure of thirteen per cent.[15] The issuing of emergency currency at such times against *ad hoc* securities or the transfer of the Home Cash Balances to the Indian counterpart by placing sterling securities in the P. C. Reserve and issuing P. C. notes against the same, thus augmenting the Government cash balances in the hands of the Imperial Bank or the manufacturing of bills to secure their rediscounting at the Controller's hands was often resorted to on several occasions. These medieval methods of finance have to be scrapped as early as possible. It is high time that the seasonal emergency or cyclical or secular and abnormal needs are properly looked after. All Central Banks are now armed with the privilege of note-issue and their purposeful credit policy even in normal times is so directed as to enable them to tide over the cyclical period with the least possible disturbance. Seasonal needs can be adequately provided for by

[15] The lowest record to which the cash reserve proportion of the Imperial Bank has ever fallen was 9 per cent.

mere expansion of book-credits, *i.e.*, deposits and notes and no penalty bank rate is ever inflicted on the businessmen. The proportional system of note-issue which is backed by commercial paper, can duly empower the Central Bank to meet the needs of seasonal as well as cyclical emergencies. But no modern banking system is being so managed at present as to secure the secular stability and stablise prices in the long period. In an abnormal contingency as war, all the three expedients of loans, external as well as internal, the screwing up of the rate of taxation and the resort to note-issue would be inevitable. The more costly the modern war is the more effective must be the three methods of war-finance.

Difficulties of Open Market Operations.

It would be mere folly to minimise the real dangers which the Central Bank would have to experience in the early days of its existence. The financial good that it can hope to render would not be very prominent from the very beginning. The immediate changes that it would bring about must be studied. It would necessitate the transfer of note-issue powers at present exercised by the Government of India.

Secondly, it would involve a cataclysmic change so far as rediscounting of *hundies* or "manufactured" bills by the Controller is concerned. The rates charged for this rediscounting have varied from six to eight per cent. To substitute merely for this purpose a Central Bank would be unnecessary for oftentimes there had been no such rediscounting at the Controller's hands even at the time of the busy season. During the present season (February, 1930) there has been no creation of this emergency currency thus far. Money rates are easy and though up-country demand might be felt sooner (February, 1930) or later it is quite likely that this demand would not be made by the Imperial Bank.

Thirdly, the lack of a discount market and the absence of bill habit need not be commented upon. But unless a

Central Bank helps this process of perfecting the shor -ter money market, the development of the same would never take place within a reasonably short time.

Nextly, the demand for loans in an agricultural country would be inelastic and discount rates can never hope to exercise effective control over the situation. As at present the bank rate of the Central Bank would be a mere symbol devoid of any real significance. For some time to come that would be its fate.[16]

Another reason pointed out elsewhere is the opposition of the Exchange Banks who would not curtail their dependence on the London Money Market either for rediscounting their bills or for investing their liquid resources in the short-term money market of London.

Still another dominating factor delimiting the usefulness of the Central Bank should be stated. Even in the advanced countries it is now being realised that immediate stabilisation of prices or business would not be forthcoming out of a judicious use of the bank rate or open market operations. Considering the "agricultural lag" fluctuating or changing price-levels would have more pronounced effect on the farmers than on the industrialists. However much the need for benefiting the farmer by means of a stable price-level might be felt still in actual practice it cannot be realised without other helpful factors co-operating with the Central Bank in improving the situation.[17] The new gold standard itself is the best regulator of prices and any conscious stabilising of internal prices would mean continuous rigging of exchange up and down with reference to movements of world prices. As the different countries of the whole world have rejected the policy of stabilisation

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[16] *See* the Section on the Future of the Foreign Exchange Banks—Part of my written evidence before the Central Banking Enquiry Committee.

[17] The success of the open market operations of the F. R. Board is much exaggerated and the helpful factors which pulled in the same direction are forgotten. *See* Lawrence, "The Stabilisation of Prices," p. 472.

of prices by adopting a managed currency and have returned to the new gold standard the objective aim of this country should be to return to this new gold standard and consider it as a good enough measure for regulating prices.

If these are the real objections to the successful working of a Central Bank it can be pointed out that the main reasons why a Central Bank would be necessary in this country can be stated under three broad headings.

Firstly, the monopoly of the foreign exchange banks has to be broken down by helping the competing local exchange banks.

Secondly, it would prevent a recurrence of the 1913—1915 banking crisis. This prosperity crisis was due to capital being lent through banking channels for industrial purposes. When the knock came they found themselves in a peculiar situation and no one was willing to help them. Their inevitable collapse brought down a number of banks. The presence of a responsible leader rendering discriminating help could have saved some of the solvent banks. No worthy lead was given by the Presidency Bank of Bengal even though the Government was willing to grant aid. The lessons of this crisis unfortunately were lost and no tangible good, immediate or deferred, resulted out of this crisis. No amalgamations, no purification process, no reconstruction schemes such as those which followed the Australian Crisis of 1891 to 1893 have resulted.

Thirdly, an orthodox Central Bank whose functional simplicity might be rigidly adhered to would facilitate and improve the remittance business of the Government, provide the rediscount facilities for the commercial banks, manage the currency and credit system of the country and perform Government business on strictly intelligent principles. The most important innovation would be the rediscounting of *hundies* by the joint-stock banks which is now considered as a weak sign and not resorted to by them.

This would enable the spread of the banking net far and wide. It would increase the scope of the Central Banker to exercise his power over the entire banking field. The slow popularising of the credit instruments, the encouragement of the deposit habit, the training of men fit to run banking institutions and the efficient handling of the banking system during the times of a crisis would be some of the immediate beneficial advantages arising out of a Central Bank of Issue. But to secure even these simple benefits it has to fight against tremendous odds the most prominent of which are popular apathy and ignorance and the jealousy of the foreign exchange banks. But if it pursues a bold, active, forceful and energetic policy there is no reason to doubt that it will eventually occupy its rightful place in the Indian money market as the corner stone of its currency and credit system.

APPENDIX IV.

A BANKER'S REGISTER.*

Nothing is so unfortunate as the lack of a suitable definition of the word "bank" and "banker" in this country. Neither the Indian Stamp Act (Sec. 20) nor the Bankers' Book Evidence Act (Sec. 2-2), nor the Negotiable Instruments Act, nor the Indian Companies' Act (Secs. 4, 136, 259) have attempted to fix the precise meaning that can be attached to banking. They attempt to interpret the word "Bank" in the sense of Banking. It is indeed as vague as the classical definition of Prof. Walker who defined money as follows: "Money is what money does." If the law fails to be very informing in this respect, the same lack of precision is attached to the use of the word "banker" in the ordinary nomenclature of "the man in the street". He generally understands the word "Banker" as a dealer in monetary credits. Even a mere interest-grabbing money lender who generally depends solely on his own large capital resources is often referred to as a banker. He does not shrink from exploiting the public by designating himself as a banker. Understood in its real sense and in the way in which it is often understood in the Western countries a bank must deal with other's money and receive deposits as a matter of ordinary business. Interpreted in this manner all indigenous bankers who refuse to deal with deposit business, itinerant money-lenders, and partenership money-lending firms would have to be excluded from the category of bankers, for they seldom conduct business on lines of modern banking which includes deposit-attracting and the payment of the same by means of cheques.

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This anomaly has to be rectified, and without a careful definition of the word "bank" it would be indeed difficult to protect the public against usurious money-lenders, pure and simple. Again, the protection extended by the N. I. Act cannot be secured unless the word "banker" is clearly defined. The granting of certain privileges to banks and bankers to facilitate the successful performance of their quasi-public duties cannot be carefully done without an adequate definition.

The compiling of a register of banks and bankers is the only safe course that can be adopted under the present circumstances. The meaning of the word " bank " and " banking " can be understood in the Western sense. Those who receive deposits of money either on current accounts or on fixed deposit accounts subject to payment by cheque and the lending of money should be styled "banks" or "bankers". All these can be registered as banks or bankers. In an age, when every profession has this registration business done satisfactorily, the bankers cannot hope to place any real obstacle to the carrying out of this suggestion. Even the slow-moving Indian public have become familiar with the business of registration of professions such as doctors, lawyers and other learned professions. An independent body should be set up to prepare this register for admitting and rejecting applicants, always bearing in mind the above-mentioned business of banking and the circumstances of the business of the applicants. The general public would have to understand that the registration of banks and bankers is no certification or guaranteeing the probity and business capacity of the registered bankers. This seems to be the only common-sense solution which can be adopted in this country. Specialising banking institutions would necessarily be included in the register. These can be kept separated from the cheque-paying or commercial banks. The title of quasi-banks can be adopted to include the co-operative and other kinds of specialised banking institutions. The Burma

Banking Enquiry Committee* points out the adoption of this plan as early as possible. As a matter of fact it was Sir John Paget who initiated the above proposal in England and it was heartily endorsed by the leading bankers, such as the late Dr. Walter Leaf. A bill was drafted to bring about this register but it was not passed (*see* Sir John Paget—Law of Banking, p. 3).

Registration involves certain duties, the successful execution of which would entitle the bank or the bankers to obtain certain coveted privileges. Some of the duties would necessarily be the publication of statements, returns and accounts and the due auditing of the same by professional accountants. Some registered bankers or banking institutions should be granted facilities mentioned in the Indian Stamp Act, the Bankers' Book Evidence Act and the Negotiable Instruments Act. Facilities in discounting hundies and in remittance operation can also be granted to the registered banks by the Central Reserve Bank, if it were to be started. Membership to the clearing houses can also be thrown open. The local gazettes can be used by the tribunal for registration and disregistration of the banks and banking companies. Annual publications of the registered list can be sent out to all without prejudice either to those whose names have been unfortunately omitted by oversight or making the Government liable, in case of failure, to deliver the list to the bankers. All foreign banking companies, which conform to the above definition of banking, can be registered by the tribunal as banking companies subject to the same obligations and restrictions as their Indian comfreres are put to. Existing persons or companies recognised as banks and protected by the N. I. Act should not be deprived of the right of registration. This simple and clear procedure would eliminate the present misunderstanding of the meaning of the words "bank" and "banker." Those who do the business of a banking as an

* *See* pages 295-297 of its Report.

ancillary business should be excluded from the register, solely on the ground that the averaging of risks which is the main function of sound banking is solely neglected by them. Many of the private banks and private loan companies which undertake ultra-banking operations would likewise become eliminated. For instance, in Bombay, there are about 13 private companies registered as limited banks. There are several unregistered financial concerns conducting banking, along with such transactions as those of capitalists, financiers, concessionaries, and merchants, contractors, traders, and speculators. The door should be closed to such people as w as to the money-lenders, pure and simple, although they might be undertaking to keep fixed deposits to a small extent. Money-lending-cum-banking firms which undertake the keeping of current accounts and fixed deposits and agree to honour the cheques of their customers would, of course, be included in the Register.

The complexities of modern business generally get heightened if the term banker is not defined. Equally vexatious consequences result out of the present-day inability to define the word "customer". The older and narrower view prevalent in England was to consider anyone a customer if he had the recognisable habit of dealing in the nature of regular banking business. (*See* the decision in the case of the Great Western Railway *vs.* London and County Bank—1901). A stray and sporadic or isolated transaction with a bank does not entitle the party to be styled a customer. The wider and the latter-day opinion* is to discard the question of duration altogether as the essence of the customer's relation. The mere payment of a single cheque for collection entitles one to be styled a customer of a Bank. At present neither of the views are

* *See* the decision in Ladbrook *vs.* Todd—(1914). *See* also the Privy Council's ruling in the Commissioners of Taxation *vs.* English, Scottish and Australian Bank (1920).

adhered to and the opinion is fast gaining ground that a customer is one to whom the Bank delivers a cheque book and the moment the delivery takes place the relationship of customer arises between the Bank and the individual opening the account. Understood in this sense a customer is one who has entered into a contract with the Bank which undertakes to honour his cheques and to credit his account with the value of the cheques payable to him and handed over to the banker for collection. This is the best acceptable definition for the purpose of the Negotiable Instruments Act.

Such clear cut notions are necessary to let the public know who are the real bankers, and the bankers themselves ought to know what their duties are and what privileges are conferred on them. Finally they ought to know who their customers are and their duties and responsibilities to them.[1]

[1]It is a matter of gratification to note that Mr. V Ramadass Pantulu elaborates these conceptions clearly in his minute of dissent. The Register should not be a "mere writ of restraints" but a "Magna Carta of their rights and privileges."

APPENDIX V

THE EXTENSION OF THE CO-OPERATIVE CREDIT MOVEMENT.[1]

While criticising effectively the suggestion of the extension of the present-day type of the co-operative societies, attention has been drawn towards the necessity of making them realise the true and right spirit of the co-operative movement.[2] Real self-help, mutual trust, neighbourly help and corporate responsibility, which are the fundamental features of true co-operation, should pervade all actions from the procuring of credit down to the smallest line of economic activity of our people. The number and the variety of lines of co-operative activity in the field of associated human action should increase and the co-operative credit movement itself should be based on scientific lines so as to maximise the benefit and minimise the human efforts needed to secure these advantages and enable them to enjoy an honourable living.

Times without number, I have pointed out the disadvantages of the lack of specialisation in the domain of credit. But the suggestion for a joint working of the short-term and long-term loans on the part of the present-day co-operative credit societies, *i.e.*, the Central Banks, is advocated afresh.[3] Reference to existing conditions is pointed out as a justification for the recommendation. The example of "mixed banking" of Germany and the theoretical possibility of segregating the two lines into two distinct departments is also often quoted in support of this line of reasoning. Although

[1] Published in the *Indian Insurance and Finance Review.*

[2] *See* my "Present-Day Banking in India," Chapter on Co-operative Banks.

[3] Most of the Banking Committees of the Provinces with the exception of the Bengal Banking Enquiry Committee have not wisely approved of this line of reasoning. It is indeed a few theorists, who wish to gain prominence for themselves, that advocate this idea for the reasons mentioned in the text.

these pros are weighty ones yet there are indeed many cons which have to be studied before this suggestion can be acclaimed as a useful one. Whatever might be the compelling necessity to grant long-term loans for making productive improvements on land or for redeeming mortgages such an unwise combination of two different lines of credit in one and the same hand is bad, illogical, and dangerous. That two redoubtedly pernicious tendencies have resulted out of this attempt to dole out the two-fold lines of credit by one and the same institution has to be understood in this connection. Firstly, the tendency to demand long-term loans even for genuine short-term purposes has crept in.[4] The prevailing illiteracy is such that the *right* use of credit at the *right* moment to the *right* limit is not understood by the people. Secondly, the co-operative short-term credit is based purely on personal security and when once the mortgage of material security or assets is tolerated for securing long-term loans, the personal element would be lost or sacrificed to the mortgaged property or security.[5] Under a distinct land-mortgage credit based on co-operative lines such principles would not be forgotten and the moral value of the co-operative movement not be lost.

An examination of the latest annual reports of the Co-operative movement in the different presidencies reveals the progress of the movement in the field of credit as well as non-credit activity. So far as credit activity is concerned the system of voluntary deposits and savings deposits has been working satisfactorily in Bombay. The use of Home

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[4] *See* the recent Report of the Calvert Committee on Co-operation in Burma. It advocates entire separation of the two features of credit, *viz.*, long-term and short-term credit.

[5] Mortgage credit cannot be easily dispensed with. The title to land, its freedom from encumbrances, its exact value, its net income, and such other aspects have to be ascertained and this is no easy task. The financial equipment needed to lend on mortgage business can scarcely be possessed by the present-day short-term co-operative banks.

Safes, the attracting of long-term deposits and other kinds of 'lying' deposits are some of the salient features of the co-operative movement of Madras. The entire dependence on fixed deposits forms the peculiarity of the co-operative movement in Bengal. Village societies of unlimited liability with a share basis and dividends have done much to stabilise the financial condition of the co-operative society. A more prompt payment of the loans is being enforced than before.[6] Delay in the making of loans is also being eliminated. An effort is being made to extend the current of co-operative activity in the direction of non-credit activities of the people and Bengal is once again in the forefront of economic activity and much progress has been recorded in this direction in the field of milk distribution, the prevention of malaria in villages, and the settlement of middle class families on land. Most of the primary societies do not fall under the category of "hopeless." The number of "average" and the "good" or "model" societies is on the increase everywhere while those that are usually classed as "bad" societies are on the decrease. There is, however, room for considerable progress in this direction.

The financing banks of the village co-operative societies known as the Central Banks are tending to provide the needed capital and have often in the past interfered too much with the administrative details of the primary societies. Their anxiety to secure the safe return of their capital literally forced them to divide this authoritative task of inspection with the Government officials, the Union and other bodies of the primary societies. In most cases it has tended to stifle the genius and the true spirit of co-operation and has made the primary units mere branches of the financing banks. The banking unions

[6] The recent Calvert Committee explains the failure of the Co-operative Credit movement of Burma as due to the unpunctuality in the matter of repayment of loans. The Government had to literally sustain a loss of about 30 lakhs of Rupees for resurrecting the co-operative movement in Burma.

or the supervising unions or the guaranteeing unions[7] have all been initiated in the different provinces to remove this danger and to run the primary societies on proper lines.

The Central Banks besides providing the capital tend to act as the balancing mechanism of the funds of the primary societies. Highly valuable as the ceaseless training ground[8] for the village societies' directors in the field of finance they are destined to play an important part in fusing an organic touch between the primary societies and the wider money market of the country. In addition to this they can initiate new lines of co-operative activity on behalf of the member societies, supervise and control their activities by their eternal vigilance although the Government auditing and inspecting staff or the honorary workers of the supervising Federation are supposed to be doing the same. Provided with more fluid resources the Central Banks can easily finance the short-term requirements of the primary societies.[9]

To complete the financial machinery the Apex Provincial Co-operative Bank has been created to act for the Central Banks much in the same way as the Central Banks do for the primary societies. But a close nexus has not been established

[7] The recent Calvert Committee recognises the danger of regulating the supervision of the primary credit societies. The credit trustworthiness of the members cannot be properly guaranteed by the Gauranteed Unions. As they have never supervised the primary societies it has recommended their entire abolition. The inspecting staff, when properly trained, should inspect and act as sympathetic guides and teachers to the societies. The Punjab model is upheld as worthy of imitation.

[8] It can be stated that businesslike dealings exist here alone. The paid secretaries, the careful manner of handling cash resources, the exacting of securities from officers handling the banks' cash are instances of wise and efficient management and the primary society can learn this aspect much to its advantage.

[9] Dependence on the overdrafts of the Imperial Bank of India for the formation of the fluid resources is bad and ought not to be freely indulged in. This feature has to be removed at the earliest stage. It is not financial prudence to count on the unstable funds as part of their fluid resources. The present practice of counting upon the Imperial Bank for supplying 75 per cent. of the fluid resources is bad. Its overdraft ought not to be higher than 25 per cent. of the total fluid resources.

as yet between the organised provincial co-operative finance and the short-term money market. High money rates might be prevailing in the short-term money market, but the surplus deposits of the financially strong Provincial Apex Co-operative Bank even, are not transferred to mitigate the tightness. Investing in Government securities instead of depositing in Commercial Banks[10] or lending the surplus to other Apex P. C. Banks is the present-day feature. If there is paucity of funds it is strengthened by funds secured from Imperial Bank which grants cash credits. The other joint-stock Banks also are now discounting the co-operative paper rather freely.

The starting of a Central Bank of Issue with regional branches would simplify this matter. Co-operative surplus money can be made available to trade and commerce and *vice versa*. Fluidity of capital which is not at present secured by holding excessive Government investments can be secured out of this arrangement. The main duty of the Central Reserve Bank, then, is to link and co-ordinate the co-operative short-term rural finance with the short-term money markets of the different financial centres. The starting of an All-India Co-operative Apex Bank might tend to defeat this laudable endeavour. It might tend to perpetuate the present aloofness of co-operative finance from the general financial machinery of the country or increase another unnecessary link in the chain of the financial intermediaries. An alliance with the outside financial sources is absolutely indispensable for the co-operative movement at its present stage.

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[10] In Bengal there is the useful practice of lending these deposits to trade and commerce and investing in Government securities. As the deposits increase at the time when there is monetary stringency in the market they can be placed safely as short-term deposits in the commercial banks. This method of treating superfluous money is better than lending to building societies and other forms of co-operative societies needing long-term loans to finance their activities. The best remedy for surplus co-operative funds is to stimulate agricultural activity by granting liberal loans to district Central Banks and help the process of orderly marketing on the part of the agriculturists.

Now that the co-operative land mortgage banks have become an accomplished fact the retrograde measure of fusing short-term finance with long-term finance should not be encouraged or recommended as a safe measure by the Indian Central Banking Enquiry Committee. As it is possible that tenants possessing no mortgageable rights in land they cultivate require capital for long-term purposes, the co-operative, land mortgage banks for these can be started on the material securities they might hold, and as these would generally be of limited liability character for the same member cannot hope to be a member of two unlimited co-operative credit societies, the guarantee or security of another member not indebted beyond his means can be taken as the basis for the loan to be granted to the principal borrower from this type of the co-operative land mortgage banks. The co-operative land mortgage banks intended for landlords can indeed be of any use only when these tend to cultivate the land themselves. Even the societies of these owner-cultivators can be materially helped by the initiation of Registration of title to land as in the case of the Torren's title existing in the country of Australia. With a further simplification of the legal formalities involved in the transfer of immovable property the possibility of conducting these land mortgage banks without a hitch can be easily realised. In the early days when the investment habit has not been created the declaration of the land mortgage bonds floated by the federated land mortgage banks [11] as a trustee security and perhaps the State guaranteeing of interest and principal would also be of signal advantage. The matter of repayment spread over a long period as 20 to 25 years, and equal instalments being paid along with interest annually, and half or 1 per cent. more for the formation of a Sinking Fund which might be reinvested within the movement, would facilitate the member-borrower's loans from the primary

[11] Pamphlets explaining the procedure of securing a loan and the way in which the Apex P. L. Mortgage Bank would work would simplify matters.

society. These would collectively be responsible for the loan amount to the District Central Land Mortgage Bank and this would in turn be responsible to the Provincial Apex Land Mortgage Bank which has to work in co-operation with [12] the existing short-term co-operative machinery, the agricultural and the industrial departments of the State.

With an all-round improvement in educational environ ment and the social surroundings of the village, the success of the movement would be facilitated and just as the short-term co-operative machinery has been initiated, protected, controlled and financed, at least in the early stages, and which still continues in a modified degree to the present day in some of the provinces, the state-aid has to facilitate this movement, for without the repaying of the present oppressive long-term indebtedness and the securing of further capital for financing the needed long-term improvement on land which can afford to yield their revenue only in driblets spread over a long period, no lasting benefit can accrue out of the short-term co-operative financing machinery alone. If the much-talked-of routing of the *mahajan* or *sowcar* is to be an accomplished fact, both these societies should pool their resources, activities, organising capacities and solve the indebtedness problem of the ryot.

If the non-official bodies existing for propaganda work, consolidation business and extension of the current of co-operative activity into other lines are working in conjunction with the official machinery whose business is to cautiously relax its grip in proportion to the real activity, enthusiasm

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[12] This would help the easy flow of funds from the short-term to the long-term credit institutions as the exigencies of the situation demand such transfer. Again it would enable the L. M. Bank to know the uses to which the borrowed money has been put to. It would be preferable for the L. M. Bank to make the disbursement itself on behalf of the borrower instead of lending the sum to the borrower direct. This would ensure the right use of credit and the main object of the co-operative movement is to see that the borrowed money is put to the right use.

and encouragement of the non-official workers, the success of the movement is certain, and rural regeneration would become an accomplished fact only then.

Lesser officialism, more competent non-officialism, more propaganda work, more activity in the non-credit sides of co-operative agricultural activities, more permanent capital attracted as deposits, spread of higher banking knowledge imparting financial skill, and the necessity for prompt repayment, the formation of a greater reserve fund, lesser display of the profit-hunting tendency to secure dividends and commercialised co-operation, greater real honesty, and more sincere earnestness would enable these people to tackle the many-sided problems facing them in actual life.

This is how the Hadaspur Co-operative Credit Society has been able to metamorphose village life within a short period of twenty years. The success of the society is undoubtedly due to the realisation of the cardinal fact that adequate and prompt finance would be useless without proper and productive use of the same under direct supervision, intelligent initiative, and prolonged guidance of sympathetic and trained non-officials or honorary organisers, who realise and possess high sense of civic conscience. The popularising of the credit instruments such as cheques and bills would solve the currency problem to a great extent.

To-day, India is a country of small farmers, often illiterate, self-contained routine men with almost a proverbial feeling of jealousy towards one another (a characteristic failing of the agriculturists all the world over). A policy of co-operation amongst such men is particularly difficult to achieve. But time and education alone would prove their saviours and regulate their pace and activity in the right directions so that the future citizens of India might be born, bred and brought up in co-operative institutions alone.

APPENDIX VI.

THE FUTURE OUTLOOK OF THE INDIAN JOINT-STOCK BANKS.*

I

The future can be built on the present which is but the result of the past. Considering the present position of the Indian Joint-Stock Banks[1] any serious study would disclose that the following are their predominant features. Lower dividends than in the immediate past or fairly even rates of dividends as in the past, decreasing working capital when understood in correlation with the increased price-level, lack of confidence on the part of the public, sheer inability to secure any prompt financial aid and over-investment in the gilt-edged securities due to lack of a fluid market for short-term investments are some of the salient features of the present-day Indian Joint-Stock Banks. The pathological point of view has strong fascination for me. As in Mathew Arnold's famous lines, I wish I were able to diagnose the evils of the banking system.

> He took the suffering human race,
> He read each wound, each weakness clear
> And struck his finger on the place
> And said, "Thou ailest here and there."

But the inadequacy of statistical material precludes anyone from playing the part of a banking pathologist. Its being scattered or diffused in more places than one irritates any worker in the field. The Statistical Tables relating to the Banks, the Report of the Registrar of the Joint-Stock Companies, the Report of the working of the Co-operative

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* This was part of the written evidence submitted to the C. B. Enquiry Committee. It was first published in the *Calcutta Review*, May, 1930.

[1] There are 133 Indian Joint-Stock Banks with about 421 branches in all. *Vide* Statistical Tables relating to Banks in India, 1928.

movement, the Trade Journal and the weekly information issued by the Controller of Currency would have to be ransacked for what little that can be gained by these enigmatic reports. The Imperial Bank always follows the policy of, "never explain, never regret, and never apologise" and no Annual Report portraying the financial state of the country is issued. There is no Banker's Journal displaying the combined figures of their working. In the absence of such information one has to literally grope in the dark to feel his way in the matter of our banking operations and their significance on the different aspects of our economic life. The method of analysis cannot therefore be applied, for details of Bank organisation, methods and practices are shrouded in mystery.

In spite of the nominally increasing growth of the working capital of the Indian Joint-Stock Banks as denoted by the Statistical Tables[2] relating to Banks in India their present position is really deplorable. Compared with the contemporary foreign banking institutions their record is indeed a

[2] The following tables illustrate my remark—

TABLE I.

(In Crores of Rupees)

Year	1913	1918	1923	1924	1925	1926
Capital and Reserve ..	4	7	11	12	12	12
Deposits	24	42	48	55	58	63
Total	28	49	59	67	70	75

(*See* the Statistical Tables relating to Banks in India.)

If these figures are correlated with the present price-level we do not find an increase in the capital. Unless this is done we would become the victims of "money illusion" as Prof. Fisher would put it.

Year	1913	1918	1923	1924	1925
General Index of price level ..	100	157	157	158	159
Working Capital (in crores of Rs.) ..	24	49	59	67	70
Working Capital correlated to pre-war level of prices ..	24	31	38	42	38

The above tables do not take into account the smaller banks and loan companies which are conducting banking business to a large extent. The resources of the indigenous bankers are also excluded.

depressing one. As adequate banking statistics which cover the entire field are conspicuous by their absence I refrain from making any appeal to any statistical device to show how our system is progressing when compared with others. The stationary and sometimes declining dividends speak eloquently of the struggles of the Indian Joint-Stock Banks. Their low cash reserve as against their demand obligations fails to inspire the necessary confidence in the minds of the depositors.[3] Unorganised, unaided and subject to the malicious propaganda or barbed darts and vile credit-wrecking tactics of their enemies, the Indian Joint-Stock Banks are " muddling through somehow ". If timely action is not taken the unfailing and inexorable law of the survival of the fittest would soon eliminate quite a large number of these tottering institutions.

With no banking legislation, no official supervision, no fluid market for short-time investments which consequently leads to an over-investment in gilt-edged securities, no co-ordinated policy of the different joint banks, no centralised banking in the way of the rate of interest and no check against the frequent happening of swindles by directors or officers of banks the Indian Joint-Stock Banks have been unable to show remarkable progress. Though some of the Indian Joint-Stock Banks are not incapable of holding large monetary resources yet the logical consequences of the above circumstances are bank failures now and then. Now that re-organisation and radical reform of banking are under contemplation the broad lines of reform may be indicated briefly. A unified banking system with an independent Central Bank of Issue acting as a regulatory authority in a carefully developed discount market and creating elastic currency to satisfy the needs of business must be the sole objective of our banking reform. A complete rationalisation of our banking

[3] Since the sale of Government securities in the market in 1917 there has been a drop in their value.

system is needed at the present hour. It alone would tend to promote specialisation in credit business and without an efficient use of credit, agriculture, commerce and industry cannot be established with any degree of success. It is to the banker, the chemist, the physicist, and the engineer that India has to look to recreate her economic conditions and lead to a fuller utilisation of her small dormant hoards of precious metals and a better working out of the industrial opportunities thereby increasing the total wealth of the country and the prosperity of the people.

Now that a Banking Committee is examining the credit organisation of our country the position that these Indian Joint-Stock Banks would have to occupy in a well-built and thoroughly organised system has to be studied with care, insight and sympathy. It would not be far wrong to say that the Indian Joint-Stock Banks lacking the fostering guidance of a true Central Bank of Issue have been functioning in a credit organisation whose growth has been aptly compared to that of a wild jungle. The lack of positive information and detailed statistical knowledge precludes one from making any judgment as regards the safety and solidity of our Joint-Stock Banks. Although it is an accepted fact that the dividends of some of the established banks are somewhat fairly higher than returns from trading or other joint-stock companies, still the fact that more capital is not being invested in the expansion of the existing banks or the establishment of new big joint-stock banks speaks for itself. The qualitative aspect of Indian Joint-Stock Banking is far from convincing and the quantitative aspect is equally disappointing.[4]

II

What are the real causes leading to this unfortunate position? Some of the causes stated by the managers of the

[4] 339 towns out of 2300 have banks or branches or agency of a bank. There is no reason why the other towns should not be equipped with banking agencies at least.

Joint-Stock Banks are analysed and a critical scrutiny and analysis of their statement leads to certain important conclusions as regards the planning of their immediate future.

Over-investment.

Like the Imperial Bank the majority of the Indian Joint-Stock Banks hold large blocks of Government securities.[5] Even these cannot be turned into ready cash. There are no open market operations on the part of the Imperial Bank to steady their price or defeat the bearish factors and tactics of the operators on the stock market. Without reasonably stable or steady value attached to the Government securities, the banks are finding it difficult to maintain steady dividends. Secondly, as the deposit rate they pay is high the interest secured from their investments does not generally give a broad margin over the deposit rate which they agree to pay. Broadly speaking, banking profits depend on the difference at which they lend over the rate which they pay for their borrowings from the public. Thirdly, the Indian Joint-Stock Banks are therefore forgetting their social mission which is to aid commerce and industry.

It is indeed true that the holding of Government securities or trustee securities ought, generally speaking, to be considered as a healthy sign indicating the true financial strength of the Joint-Stock Banks. But unfortunately owing to the above set of circumstances described already the investment policy has been causing them grave anxiety. Again no commercial bank ought to congratulate itself on its possessing a higher amount of investments over and above their actual paid-up capital. It is bound to create grave trouble whenever it wishes to expand its business or open branches in the interior. Although full regard to liquidity has to be paid still this over-investment even in gilt-edged securities has to be given up. The English Banks persistently sold their surplus percentage

[5] *See* C. B. Enquiry Committee Report, p. 385. "A large proportion of resources is locked up in gilt-edged securities as compared with bills."

of war-time investments immediately after the war. From £398·6 millions in 1919, they came down to a low level of £290·5 mil. in 1927. The sum realised was utilised as advances to commercial borrowers.[6] Such a policy of pronounced reduction in the matter of their investment would undoubtedly improve the situation. Even the Presidency Bank of Bombay suffered in a like manner on account of its excessive holding of the E. I. Company's paper. Firstly it proposed to open a branch in Calcutta in 1841.[7] As this was not allowed, it suggested the undertaking of foreign exchange business so as to find work for its huge capital. Considering the possibility of the Hon'ble the Court of Directors refusing this measure it placed the alternative of reducing its capital exactly to one-half and that the note-issue should similarly be cut down to one crore of rupees alone.[8] The Court of Directors refused to permit any of the measures and until there was the cotton boom in 1860 there was not properly speaking any legitimate trade demand absorbing its huge paid-up capital which had to be locked up in the Company's paper alone which paid four to five per cent. rate of interest.[9]

COMPETITION.

Taking leave of the discussion of excessive investment we must turn to the second reason which is repeated by the

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[6] *See* J. Sykes, The Present Position of the English Joint-Stock Banks, p. 68.

[7] *See* my book "Organised Banking in the Days of John Company", pp. 487 to 494.

[8] *See* the Report of the Directors of the Bank of Bombay submitted at a Special meeting of the Proprietors held on Thursday, the 2nd day of September, 1852, 11 o'clock in the forenoon. These requests were not sanctioned by the Hon'ble the Court of Directors. *See* their Financial Letter to the Government of Bombay, Letter No. 1, of 1853, dated 19th January 1853. Paras. 3 and 4 of this letter explain the reasons for their refusing to sanction this request.

[9] *See* Resolution No. 19, Financial Letter from the Court of Directors to the Bombay Government, dated 26th July, 1843.

managers of the Indian Joint-Stock Banks. Since the late Mr. A. Bowie raised the cry of "uneconomic competition" on the part of the Imperial Bank it has become fashionable in season and out of season to repeat the bogey of competition. If it were not the Imperial Bank of India, the Government of India and the existing Provincial Co-operative Banks and the District Central Co-operative Banks and the Exchange Banks are looked upon as rivals tending to spirit away deposits which would naturally have flowed into their hands in the absence of any of these competing rivals.[9a]

Much reliance cannot be placed on the supposed cut-throat or uneconomic competition on the part of the Imperial Bank of India. It is the acknowledged policy of the Imperial Bank to consolidate its present position at the existing two hundred branches and not to open more branches in the meanwhile. Competition with the indigenous joint-stock banks is always deprecated so long as the latter are charging moderate rates of interest. It is the declared policy of the Imperial Bank to open a branch only where scope exists for two Banks. Even though a branch of Joint-Stock Bank might exist, the Imperial Bank would open a branch so as to extend banking facilities to the people of the locality. So long as the dangers underlying branch banking are understood and every effort is made to eliminate them, this system of extending branches by the Imperial Bank has to be hailed as a welcome measure. None the less there is a grain of truth lying hidden in these blasphemous remarks of the Joint-Stock Banks. Unable to secure interest-free Government deposits they have raised the cry of State-subsidised competition. The State, however, has to select a strong bank as its depositary for the Independent Treasury System has grave evils of its own. The system of nursing weak banks by declaring them as Government depositary banks is no less an evil than the

[9a] See Resolution No. 19, Financial Letter from the Court of Directors to the Bombay Government, dated 26th July, 1843.

one of maintaining an Independent Treasury System of its own.

Although there might be some amount of truth in the above contention, still the grievance that the Co-operative Banks are effective competitors as they tend to attract deposits by offering high interest rates is entirely a mistaken notion. As in modern Germany or France we do not find even our urban or the Provincial Co-operative Apex Banks conducting banking business on similar lines which the commercial banks adopt.[10] In Germany the co-operative banks grant advances on the well-known basis of the cash credit system and discount bills. Even in modern France the situation is the same. The Co-operative Banks created by the State initiative and financed to the extent of 50 mil. francs are acting as the ordinary joint-stock banks for the locality. Such competition hardly exists in any of the money centres of this country. It is true that the co-operative banks offer a high deposit rate. As I have stated elsewhere, they are "complementary" institutions.[11] Their sole aim is to play the humble rôle of "collecting banks." They are "feeders" to the Joint-Stock Banks for it is their mission to endow small people with moderate capital and train them to banking habits and prepare them for business with more capitalist institutions to which they are likely to go as they become wealthy. Such being the case there is no reason to take umbrage on account of their successful working. In the near future when trade financing is done by means of bills the trade paper endorsed by the co-operative banks would furnish ample opportunity for the safe investment of their

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[10] Even though the Imperial Bank's branch has been closed at Serajgunj and the local Central Co-operative bank has been attempting to fill the void the question of opening current accounts, collecting cheques and bills is not taken up and sanction has to be obtained for this from the Registrar of the Co-operative Societies for these purposes. *See* Free Press Message the *Liberty* of 12th September 1929. In some places, however, the co-operative banks are opening current accounts, purchasing drafts and selling remittance.

[11] *See* my "Present-Day Banking in India," Chapter on Co-operative Banks.

funds. Greater co-operation would thereby ensue between the Indian Joint-Stock Banks and the other kinds of banking institutions or bankers. Co-ordinated and not competitive banking must be the ideal that ought to govern their operations in the future.

P. O. Cash Certificates.

The Government of India which has already incurred their displeasure for depositing its funds in the Imperial Bank alone, has once again become a target of criticism. By virtue of increased interest rates which it has agreed to pay to the holders of the P. O. Cash Certificates from the 1st of August, 1929, it is feared that it would tend to divert the flow of deposits from the usual channels to the hands of the Government of India. That the Government would absorb the available savings is the specific grievance which has been set up by them. Even the Exchange Banks consider this effective competition on the part of the Government as one of the reasons for the slow growth of their deposits. The floating of Treasury Bills and the currency contraction in the slack season, though ostensibly pursued with the object of propping up exchange is disliked by the Indian Joint-Stock Banks. The Treasury Bills are being floated at "rates of interest which no bank even of modest means could think of giving its depositors."[12] This has been acting as a double-edged weapon. Firstly, it has tended to restrict the volume of their deposits. Secondly, it has tended to demoralise the tone of the stock market and the Government securities have naturally

[12] If we study the English Banking system the average rate at which Treasury Bills were floated was £4-10s.-3d. hardly higher than the rate at which the commercialists were able to secure the discounting of the bills by the Banks which was £4-9s.-6d. This shows that the British Government in spite of its increased indebtedness did not pay very high rates for its short-term indebtedness. *See* Sykes, *Ibid.*, p. 91.

suffered depreciation as a result of unexpected shifts in the matter of Treasury Bill sale policy.[13]

Exchange Banks.

Repeated failures of the Indian Joint-Stock Banks have turned the people more to the Exchange Banks who have already become unpopular for their exclusive monopoly of financing of foreign trade. Their deposits are increasing though they pay no high rate of interest. Being the victims of unorganised banking the Indian people naturally prefer to place trust in the foreign Exchange Banks whose directors at least are to a certain extent free from the taint of swindling bank resources and utilising them for selfish advantages of their own. The Exchange Banks have built up a tradition of trustworthy service and they usually have at their service a continuous succession of honourable and loyal men. They are gathering vitality as they go becoming not weaker with age but stronger and more trustworthy in marked contrast with the few traitors of our Indian Bank management who have undermined the prestige of the other contemporary Indian Joint-Stock Banks and have contributed a good deal towards their stagnation and decay. The main excellences of the Exchange Banks, namely, skill, trusteeship and scientific method, must be copied by the Indian Joint-Stock Banks. The general faithfulness of the Indian Joint-Stock Banks is not questioned by anybody but they must copy the best features of the Exchange Banks. It is banking education that can create these features. It is not the men in high places of power but also those who are stationed in every rank and level of banking service who must realise their responsibility and be willing to do their best.

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[13] It is a matter of gratification to find that this opinion is fully endorsed by the C. B. Enquiry Committee on p. 405. "The T. Bills have not yet become an integral part of the money market at their proper value".

III

Hard Times and Depressed Trade.

The prosperity of banks is purely a relative phenomenon mainly depending on the prosperity of its customers. If the depositors and bank customers suffer from a fall in the price of land which they bought at fabulous prices in the boom days of 1921 or if dullness of trade were to prevail in the days of post war depression, it is bound to tell adversely on the banks also. There is indeed a lot of truth in the above remark. It is only in 1927-1928 that Indian trade and commerce reached their pre-war level. Trade and commerce are feeders to banking and without banking they themselves cannot be fed properly; they are as much dependent on the banks as the banks are on the traders and merchants.

Failures.

Lastly, the incessant and never-ending[14] failures of the Indian Joint-Stock Banks often remind the people of the fact that it is altogether sheer folly to place confidence in such mismanaged institutions as the Joint-Stock Banks generally prove to be as soon as their management changes hands from the original set of people. Without the continuity of experienced management a deposit in a bank cannot be

[14] The following table shows the failures of the Joint-Stock Banks in this decade—(*See* Statistical Tables relating to Banks in India):—

Year.	No. of Banks involved.	Paid-up Capital. Rupees.
1918	7	1,46,185
1919	4	4,02,737
1920	3	7,24,717
1921	7	1,25,329
1922	15	3,29,991
1923	20	465,47,325
1924	18	11,33,623
1925	17	18,75,795
1926	14	3,98,145

considered safe. Repeated failures,[15] are shaking the credit fabric of the Joint-Stock Banks. It must be borne in mind that a "system of banks is like a crowded city where a fire breaking out in one house may soon spread to many others and every house has to bear not only its own fire risk but some risks of all the rest". Without a far higher standard of banking prevailing among the Indian Joint-Stock Banks it is impossible to consider the banking structure as a sound and strong one. The present-day Joint-Stock Banks are not regarded as national institutions endowed with the trust of the community.

Having seen a correct representation of the difficulties under which the Indian Joint-Stock Banks are labouring, it is the bounden duty to plan the future of the banking system in such a way as to provide a harmonious atmosphere congenial to their rapid development. What then are the remedies needed to cure their weaknesses ? Can the Indian Joint-Stock Banks hope to improve their situation by their own efforts and measures in the direction of setting their houses in order ? What can an external agency like the Central Bank of Issue hope to do for them ? How far would the legislative and administrative action on the part of the Government and the co-operative action of the depositing public and the borrowing customers be of any use to them ? Are there any other tentative measures by which it would be possible to help them at the present juncture ? A thorough discussion of these varied factors would be impossible within the scope of this short paper.

But the definite programme of banking reform falls broadly under two headings, *viz.*, internal and external. The

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[15] Quite recently the Karachi Bank failed and a desultory acquaintance with the history of Indian Banking would show how the lack of confidence created by bank failures has been a well-marked feature since the second half of the 19th Century.

internal reorganisation has to be brought about by the Indian Joint-Stock Banks. This is more important than the external aid for without the former the external agency would either decline to lend aid, or even, if it were to be rendered, no lasting and permanent improvement can be achieved in the position of the Indian Joint-Stock Banks. An external agency can mend the evils but what is required is a radical cure which can arise out of a proper internal reorganisation.

Of the external remedies the administrative measures of Government, further legislation and a more enlightened public debt policy are given proper attention. The co-operation on the part of the depositing public and the borrowing customers and close co-operation amongst the bankers themselves would go a long way in improving the situation. But the creation of a Central Bank of issue is the proper remedy for many of the present-day defects.

Taking the internal remedy first into consideration the Indian Joint-Stock Banks would have to sacrifice or give up the unnecessarily large holding of Government securities.[16]

[16] Broadly speaking the banking policy in the matter of investments is to select liquid and easily realisable securities possessing steady value and a wide market. As gilt-edged securities possess these features the bulk of bank investments consists of Government securities. But these do not form the only item in the matter of investments. If the Bank conducts issuing business the shares of new companies floated by it are generally held by it till the time the investing public digest these shares. Similarly a city bank seeking to extend its operations in the most safe and economical manner tends to acquire shares in the banking companies of the interior and hopes to influence its policy and seek an outlet for its surplus funds. The shares of a foreign banking company might be required so as to affiliate it to itself. This might not be done with the express purpose of conducting foreign banking on any large scale but merely to render more efficient service to its own customers in the direction of financing foreign trade. Indian banks do not generally possess such a wide range of securities and shares of few stable industrial companies form the major constituents of the investment items of the Indian Joint-Stock Banks. The acquisition of interests in other banks domestic or foreign is not yet a marked feature of any one of the important Indian Joint-Stock Banks. The daring yet fruitful policy of the Lloyd's Bank or the Barclay's Bank in this direction finds no counterpart in the Indian Joint-Stock Banking System. Too large a part of their investible surplus finds its way into gilt-edged securities. This has to be rectified.

In their endeavour to incline towards safety they are leaning too much on this support. Sound commercial advances marshalled in a steady succession of maturities are more lucrative than gilt-edged securities. Banks must invest wisely and not speculatively. True wisdom in the matter of bank investment consists in avoiding "frozen assets". The problem of finding adequate business for the released funds would have to be faced. Indirect financing of agricultural interests through approved indigenous bankers or the financing of the small artisans or traders purely on the personal knowledge of the indigenous bankers can provide the needed avenues and unless they care to cultivate more regular business dealings with the indigenous bankers the mere financing of trade and industry in the big centres would not absorb all their liquid resources. The banking net must be spread wider so as to cover a greater area than at present. It is the financial life of the big cities alone that they are able to influence at present. They must descend to rural tracts and hope to influence the lives of the masses in a significant manner. The real problem of Indian Banking is to secure to the Indian Joint-Stock Banks power so as to enable them to control the indigenous bankers and they should themselves be controlled in their turn by the Central Bank of Issue. This is the unity and organic relationship that ought to pervade our banking structure. The present-day loose and unorganised system has to be displaced by a more concentrated and highly integrated banking system.

Secondly as one reputed Professor of Economics stated, "a banker ought to be two-fifths gentleman, one-fifth economist, one-fifth lawyer and one-fifth accountant". Unfortunately the lack of such high qualities renders possible mismanagement of banks. A weak, loose and inefficient audit unable to influence the bankers usually tolerates such inconsistencies, till the day of final reckoning comes when some important incident leads the depositors or lenders of

money to doubt of the standing of the bank and the attempt on their part to collect the deposits brings to an end the existence of the tottering bank.

An efficient and expeditious service and the expanding of general agency business done by them is sure to bring in greater deposits and more constituents. Banks have to go to the people and not wait for the people to come to them. If sufficient employment for these funds is secured the financial strength of the Indian Joint-Stock Banks is bound to increase. No time should be lost in attempting to reform and reorganise the internal framework on a sound basis. It is not for the sake of mere self-interest that this reorganisation has to be undertaken by the volition and prescience of bankers themselves. Unless this is carried out immediately the mere setting up of any external agencies would not solve the riddle and even these external agencies would consider these Indian Joint-Stock Banks a constant source of anxiety. The help that any external agency would render can bear fruit only under improved management of the Indian Joint-Stock Banks. In the absence of any such reorganisation it would tend to postpone the evil day. It is foul financial weather that is the real test of sound banking and I venture to think that without real improvement in the internal management of the banks their position would become strained, if another crisis of the nature of 1913-1915 period were to happen.

External Remedies.

A more enlightened policy on the part of the Government with reference to Rupee loans and the Treasury bills is needed and everything depends on this important reform. It is absolutely imperative that no further suspicion should be roused that the Government is bent on floating further Rupee loans in the Indian money market. The slackened response to the last Rupee loan means after all that it is high time to consider the advisability of proceding slowly in the matter

of capital expenditure on the part of the Government even for productive undertakings. The present market value of gilt-edged securities should not be tossed about hither and thither as a result of the vacillating public loan policy. Further depreciation of the value of Government securities means further cuts in the profits of the Indian Joint-Stock Banks and the dividends they declare. Lower dividends mean lower deposits. The lower the working capital the lower would be the profits unless it is offset by greater turnover of the capital resources. This is the vicious circle that is being induced by the present-day public loan policy.

Administrative Measures.

Several critics have pointed out the necessity of pursuing a strictly scientific policy in the sale of the Treasury bills. The resort to the Treasury bills as a deflationary measure in order to support the sterling value of the rupee in the slack season is undoubtedly tending to the reduction of deposits available to the Banks. Firm money conditions induced by their sale may succeed in bringing about an improvement in the rate of exchange and maintain it at a safe level. The high rates paid for them as well as the long term loans would mean in the long run greater inroads on the taxpayer's purse.[17]

[17] It is not germane to this topic to discuss the economic effects of public debts. The floating debt even though it might consist of Treasury bills has its effect on the Bankers. Apart from financial danger to the State, the inconvenience to trade and commerce is no less grave. The possibility of habitual renewals tends to make it permanent. This acts as a detriment to banks for their deposits would be cut down and the discount rate would rise. Prices of goods rise and the standard of living tends to become very high. The Banks might hold these safe Government promises and refuse to take risks involved in commercial loans and discounts. It is liable to provoke inflation. Lastly it might lead to grave consequences if renewals of Treasury bills are slackened. Foreign holders of these lose confidence in these certificates and national money and this loss of confidence affects adversely the the national rate of exchange.

For a more complete discussion *see* the "Revue de Science et de Legislation Financieres", January-March Number, 1925, pp. 100-102.

See also H.E. Fisk, "French Public Finance in the German War and To-day," pp. 15-17. *See* also H. C. Adams, "Science of Finance," p. 526.

This unnecessary increase of tax-burden when the taxable capacity is so very low has to be borne in mind. It would have an adverse effect on the purchasing power of the people and trade would not recover rapidly as a result of this deflationary policy which of course is due to their anxiety to keep the exchange rate above 1*s*. $5\frac{49}{64}d$. the gold export point from this country. So long as the sterling resources are few there can be no sale of gold exchange or gold at this export point in spite of the Act IV of 1927, Clause V. This perhaps is the reason for the anxiety of the Government not to allow exchange to fall to the low level of the gold export point from the country.

Legislative Measure.

Another direction by means of which the Government can hope to protect the directors as well as the public lies in passing helpful and suggestive legislation. Government guarantee of deposits or the formation of a "Safety fund" are bound to be mere palliatives and do positive harm to the conservative banks. The possibility of few depositors being selected as bank directors is a remedy which can only be permitted by a change in the existing legislation with reference to the Joint-Stock Banking Companies. Those taxes which are interfering with the development of banking amalgamations should be removed. A readjustment of the other taxes on a lower level than at present would act as a further impetus in the starting of more banks and in view of the fact that the indigenous bankers are to develop into modern banks this recommendation has to be virtually carried out. The possibility of selecting a few other banks "as public depositaries"[18] after exacting due security would have its own efficacy at the present juncture when even the established

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[18] *See* the U.S.A. where there are a large number of banks—7,224 acting as public depositaries. *See* the annual Report of the Treasurer, 1926, p. 604. "One Bank in every four is a Government depositary."

Indian Joint-Stock Banks are not able to create the needed confidence. It is indeed true that the false tongue of rumour cannot be controlled in any effective manner. Its vivid conjectures can be silenced only by publication of relevant facts indicating the general financial strength of the Banks. The financial intelligence of the reading public can after all be a more effective safeguard than any legislative enactment.

Co-operative Efforts.

The depositing public and the shareholders would have to co-operate with the bank management in every way. If the depositors are taken into confidence by the managing board there is no reason why they ought to get shy of the Indian Joint-Stock Banks. Advisory committees of depositors and influential traders to help the branch managers in the matter of investment of bank's funds would be very helpful.

Sometimes the frauds and malpractices which the Banks have experienced from time to time have led to stricter regulation and restriction of credit by the banks with the result that *bona fide* constituents suffer as a result of this vigilant attitude. This attitude should not be mistaken by the *bona fide* constituents.

The Central Bank of Issue.

The starting of a Central Bank of Issue would indeed improve their situation in several ways. Besides providing rediscounting facilities and thereby enabling them to convert their assets easily into liquid cash, a Central Bank is bound to confer inestimable advantages on them in the following directions. A careful scrutiny by the Central Bank, which would be made at the time of rediscounting the eligible commercial paper would automatically raise the standard of banking. The very example of its conservative management would act as

an elixir or life-giving tonic to the almost stagnant Indian Joint-Stock Banks of the present day. If the constitutional position of the Central Bank[19] is so devised that it precludes competition with the commercial banks this by itself would afford an impetus to the Joint-Stock Banks to extend into the interior in their endeavour to secure fresh business. But the starting of a Central Bank would indeed take time. In the interregnum, the Imperial Bank can render some good to the Indian Joint-Stock Banks by hoping to act as a Banker's Bank. There is infinite possibility in this direction and all credit institutions can be granted liberal advances at one per cent. or 1½ per cent. below bank rate on the security of gilt-edged stocks or investments so long as they fail to convert them into liquid resources. It is not by merely lowering the bank rate that the lending policy can be liberalised or made elastic. Less harsh restrictions than are prevailing at present would mean helpful overdrafts to the Indian Joint-Stock Banks and a part of the interest-free national balances secured by the Imperial Bank can be utilised in this manner. This is not entirely a new and dangerous innovation for it is a definite policy of the Imperial Bank to grant accommodation in this manner to business houses and industries. Timely help and succour and not mere spoon-feeding should be the object of this liberalised lending policy. Mere facilitating of internal transfer of funds or remittances at low rates is not by itself a very great help to the Indian Joint-Stock Bank. The starting of more clearing houses is another estimable service for which the Joint-Stock Banks ought to feel grateful to the Imperial Bank. Something further is needed in the direction of cordial relations between the Indian Joint-Stock Banks and the Imperial Bank. Both of them must realise the

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[19] This can be done by confining its business to note-issuing and discounting trade bills of short currency and it would be prohibited from doing ordinary banking business of a commercial bank.

lessons of the past and be aware of the current developments and current thought.[20]

CONCLUSION.

A clear and consistent action on the part of all the interests concerned is necessary and the co-operation of the different sections would secure to the Indian Joint-Stock Banks a solid ground for their future expansion and economic development of the country. Small Indian Joint Banks or Loan Companies are being started here and there. If the monthly report of the Registrar of the Joint-Stock Companies is examined the activity of the people in this direction can be immediately realised. But in the economic sphere it is not mere quantity but quality that tells. Few sound banks can achieve more lasting good and confer more permanent outstanding benefit on the country than many bogus banks which tend to put back the clock of economic progress. National well-being, price-levels, profits, employment and purchasing power of wages are of essential importance. Their control by a sound banking policy under the capable leadership of a nationally managed Central Bank would secure the welfare and happiness of the teeming millions of this country.

To sum up, this survey reveals much that is defective in the present-day situation of the Indian Joint-Stock Banks. To increase their usefulness, self-improvement, external aid and thorough reorganisation of the entire banking structure

[20] Even the English Joint-Stock Banks which are considered as "paragons of conservatism" have changed their policy towards industries. Even in America the banks have followed a liberal lending policy. Extended loans and less rigorous insistence in the matter of repayment are evidently a proof of their sincerity that they do not hold a too detached view towards industries as in the past. This elasticity in the matter of lending has to be noticed. *See* H. W. Macrosty, "Trade and the Gold Standard"—Paper read at the Royal Statistical Society of London, December 18, 1926—Quoted from the *London Economist*, December 25, 1926, p. 117.

are pointed out as the proper measures which can guard them against further deterioration. All parties should co-operate in this endeavour as it is a problem of national importance. The present Joint-Stock Banking system must be made safe, economical, adequate and efficient at the same time so as to afford maximum utility to all sections of the community. Incidentally it can be remarked that the present-day absence of definite trustworthy information or banking statistics has to be remedied as early as possible and such figures as would furnish real information or artfully unfold the tale of banking progress should be published by the different units of our banking system.

APPENDIX VII

THE FUTURE OF OUR FOREIGN EXCHANGE BANKS*

EARLY BEGINNINGS.

Prior to the starting of the organised exchange banks and the exchange markets, the indigenous bankers looked after the internal and external exchange requirements of the people.[1] The balance of international payments being in favour of the country gold and silver flowed[2] in freely. Such intricate economic problems as trade adversity fluctuations did not arise on any important scale.

With the advent of the British East India Company and the foreign trading companies of the western nations foreign exchange business began to develop and an insignificant part

* This was part of the written evidence before the C. B. Inquiry Committee. It was also published in the *Calcutta Review*, Nov.-Dec., 1930.

1 Until 1796-97 the Governments of the Provinces used to enter into contracts with the shroffs or the indigenous bankers for the securing of resources in the different centres. Due to the Accountant-General Mr. T. Myers the practice of the sale of bills and the inviting of open competition was adopted so that this competition tended to secure more favourable rates than before. *See* the Public Consultations, Fore William, Public Department, Government Manuscript Records, Imperial Record Office, 7th January 1800, No. 47. The Bombay Government adopted this practice so that by selling bills on the General Treasury at Calcutta it could secure the additional revenue needed to meet its requirements.

2 Bengal, for instance, not only paid for all its imports but could finance the requirements of other provinces and the China trade at the same time. This led to the drain of specie but gradually it was condoned by a development of the export trade, the founding of banks and a thorough organisation of the currency system. *See* the Public Department Records—The general Public Letter written in April, 1809 to the Court of Directors so as to convince them of the necessity to grant a charter of incorporation to the Bank of Calcutta. It was only after receiving this charter that the name was changed to the "Bank of Bengal." Up till 1809 the Bank of Calcutta was always referred to as the Government Bank in the index of the Government records.

of it might have been conducted by the Indian concerns and "black merchants" as the Indian people were styled in the records of the East India Company. It was not until the Agency Houses happened to conduct money exchanging, banking and commission business, etc., that there was any advent of the organised banking system into the country. The first large scale moffusil banks were the Union Bank of Calcutta (1829), the Agra and the United Service Bank (1833) and the Bank of Western India (1842) and the Commercial Bank of India (1845). These were unlimited co-partnership banks and their avowed object was, of course, internal remittance and banking business. But as the heirs of the goodwill of the Agency Houses they soon began to acquire foreign exchange business and the prohibition on the part of the Presidency Banks helped them a good deal in this direction.[3]

Advent of the Foreign Exchange Banks.

From 1851 the entry of the exchange banks into India becomes noticeable.[4] More banks would have been started if the East India Company had been more tolerant towards them.[5] During 1858 to 1862 the Comptoiré Escompte de Paris gained entry into this country. Gradually the British, American, German, Dutch, Japanese and the Portuguese banks began to conduct foreign exchange business in this country.

The domestic banking system being insignificant and the few major banks being restricted largely by statutory regulation, these foreign exchange banks, though few, soon acquired

[3] At the instance of the Director Cockerell this prohibition was enacted, *See* my Present-Day Banking in India, 3rd Edition, Appendix III.

[4] The Oriental Banking Corporation was the first chartered bank of London to gain entry into India.

[5] *See* the opposition of the East India Company to the starting of a Bank of India in 1836, the Bank of Asia in 1840 and the Chartered Bank of Asia in 1851. See the Bank of Asia Correspondence issued as a Parliamentary Paper in 1843, Vol. XXXV.

prominence. They secured monopoly over the exchange and remittance functions. So late as in 1875 the Anglo-Indian Exchange Banks were hardly considered as "banking institutions."[6] Working in an uncongenial atmosphere and subject to the deterrent disabilities of controlling branches stationed thousands of miles away from the head office the administrative capacity of the exchange banks might have had been seriously undermined but for several helpful factors. Their commanding resources, the lack of effective competition on the part of the small Joint-Stock banks at the time of their entry into this country and their implicitly following the unwritten rules of sound banking soon earned for them the respect and confidence of the public and gave them an opportunity to succeed and outdistance the local banks in spite of all benefits which the latter could derive from the patronage of local people and merchants.

By the time the exchange troubles of 1872 to 1892 began to appear the Indian Exchange Banks wisely succeeded in sending back the whole or a large part of their capital to their head office.[7] At present about 19 such foreign exchange banks exist. All these are foreign-owned banks with their head office outside India. They do not deal with the financing of internal trade or industries *quite on a large scale even in the slack season*[8] when they find plenty of loanable resources in their hand. They are unhampered by any discriminatory

[6] *See* the Evidence of the Deputy Governor of the Bank of England before the Select Committee on the Banks of Issue of 1875.

[7] See the Evidence of Sir Alfred Dent before the 1898 Committee on Indian Currency, Qn. 1959.

[8] Mr. Manu Subedar says that it is internal banking that is more important of their work. He does not quote facts and figures in support of his statement and it is a matter of regret that his attempts to secure detailed information failed in every respect. *See* Annexure I of the Minority Report.

laws as is the case in America or in the foreign countries.[9] Spreading their operations over a wide area these banks have succeeded in minimising the risks arising from local trade fluctuations. As in Japan where a number of important private Japanese banks exist with extensive foreign departments both at home and abroad we have no such domestic institutions on any important scale. They are conspicuous by their absence. It has been an oft-repeated cry on the part of the nationalist economists that locally directed exchange banks do not exist.

Exchange Brokers.

Although there are exchange brokers in the important money centres, yet they do not exist in such numbers as in the case of the well-developed exchange markets of London or New York.[10] There are also finance brokers who are sometimes interested in bonds and shares but their exchange business is little. Exchange brokers can be defined as those whose sole business is broking exchange bills and conducting deals in future.

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[9] *See* Willis and Edwards "Banking and Business," New York, 1925 Edn., p. 28. *See* also Willis and Steiner, Federal Reserve Banking Practice, New York, 1926 Edn., p. 552. France, Denmark, Turkey, Japan, and Spain have special restrictions imposed on foreign banks but wherever such regulations have prevailed it has become the habitual practice on their part to affiliate themselves with domestic capitalists and start institutions working under local laws. Even England is supposed to have scented dangers in this matter and the Cunliffe Committee recommends an examination of the situation with reference to the "open door policy" maintained by the United Kingdom as regards the entry of foreign banks. But so long as the United Kingdom invests abroad and is anxious to retain the world's financial leadership the London money market must be wide enough to allow operations in diverse currencies and foreign banks must be allowed to conduct their operations. As a guarantee against repudiation the investment of the foreign banks in London would be of some use.

[10] When an Indian Exchange broker dies his place is left vacant so that members might be limited. There is no single Association including European as well as Indian exchange brokers either at Bombay or Calcutta. European banks prefer to have dealings with the *deposit brokers* who deposit Rs. 10,000 as guarantee of ratification of contracts. *See* p. 429 C. B. Enquiry Committee Report.

Aggregate Foreign Exchange Bills.

The aggregate amount of foreign exchange bills[11] which can be drawn through the foreign exchange banks can be arranged roughly under—

(1) Imports and exports.
(2) Gold and silver.
(3) Invisible trade.
(4) Capital movements.

But as no accurate figures can indeed be available under all the above headings specially three and four being purely conjectural it is only a rough idea that can be gained of the actual exchange business transactions. To these must of course be added pure exchange speculations which can only be left to wild conjecture or happy guess. After the recent war this business has increased enormously but it is not yet the usual practice on the part of the Indian merchants to cover all exchange transactions of theirs.

Exchange Rates.

Orthodox foreign exchange theory asks us to analyse the forces of supply and demand for understanding the fluctuations in the exchange rates. The modern exponents of this theory like Cassel, Keynes and others consider the purchasing power parity as the true indicator of the trend of changes in the foreign exchange rates at least in the long run.[12] During the short period speculation, budgetary situation, and capital movements, exercise their influence. Due to the fact that the Government of India pursues a policy of stabilising exchanges the deviations from the artificially

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[11] *See* the Memorandum of the League of Nations on International Trade and Balance of Payments, 1913-1927, pp. 143-150.

[12] *See* Gustav Cassel, the World's Monetary Problems, J. M. Keynes, Tract on Monetary Reform, p. 88. *See* Angell, Theory of International Prices, pp. 188-90; Nogaro, The Modern Monetary System; De Bordes, The Austrian Crown, pp. 198-200; U. S. Commission, Gold and Silver Inquiry Series, 9 (1925).

established par cannot be very wide nor lasting for a long time. During the slack season the exchange rates would be at the lower level or the gold export point and unless monetary stringency were to act as a buoy exchange practically would be only roughly $\frac{1}{32}d$. or $\frac{1}{64}d$. above the gold export point from the country, *viz.*, 1*s.* $5\frac{49}{64}d$. Within these limits it is the exchange banks which receive exchange news from the chief important centres of the world that determine the rates every day on the foreign countries. These are published in the local newspapers on the next day. The other Indian Joint-Stock Banks who conceivably conduct foreign exchange on a limited scale for their own customers adjust their rates on the foreign exchange bank rates. Though there is not much brisk activity on the part of the Indian Exchange brokers some amount of arbitraging in exchanges and dealings in futures are entered into on their own account. They are undoubtedly busy making and receiving quotations of rates from merchants and banks and it is not germane to this topic to discuss their activity and bustle at the telephone.[13] Their anticipations however do contribute something towards levelling the exchange rates.

Characteristic Features of Exchange Fluctuations.

A scientific study of the exchange rates points out that there are two distinct features, *viz.*, the strengthening of the exchange rate in the busy season and the slackening of the exchange rate in the monsoon season when it is at the lowest level. This general movement is usually smooth and no wide range and spread of fluctuations presents itself. The lack of trade or export bills, the abundance of money in the slack season which is usually in the first half of the official year (April to September) and the floating of the rupee loans

[13] For a comparison and contrast of the work of our Exchange Brokers with those of the West, *see* F. T. Rushforth, the Indian Exchange Problem and Phillip's Modern Foreign Exchange.

whose sole proceeds have to be converted into foreign currency to finance capital expenditure on goods explain the low exchange rate of the rupee. This is the period of weak exchange. Expanding trade increases export bills and tight money conditions raise the exchange rate to the gold import point of the country. This is the period of strong exchange. Each successive season these features are reproduced with almost clock-like regularity. Under the Gold Exchange Standard system there was a literal pegging of the exchange rates of the silver rupee and no great devitaions or spread of the rates could be noticed in either of the seasons. The releasing of gold or gold exchange from the Gold Standard Reserve at the gold export point from the country and the purchasing of unlimited quantities of sterling or gold exchange whether required for immediate *bona fide* expenditure use of the Government or not when the exchange rate is fast rising, are the present-day methods to curb the exchange fluctuations. Acting as the currency authority the Government have been in a position to have tolerable control over the exchange market. On the whole the system has worked fairly well. At certain times the Government did not resort to the release of gold from the Gold Standard Reserve at the gold export point but have used the "Defence Treasury Bills" to contract currency and steady exchange at $\frac{1}{64}d.$ higher than the gold export point from the country. Similarly gold might not have been permitted to enter the country by unlimited sale of purchase of sterling at a lower rate than the gold import point of the country. According to some measure or other the cherished object of stability of exchange has been realised. The statutory obligation under the Indian Currency Act of 1927 is being fulfilled. Exchange remains pegged at the 1*s.* 6*d.* ratio. The Bankers who dislike the treasury bills floated at competitive rates or even higher rates might have noticed a few malpractices. The Government are undoubtedly feeling the strain to maintain exchange a burdensome one but the net result that the ratio has been

observed must be conceded. The *status quo* has always been maintained and there was no serious exchange slump at any time during these two years 1927 April to 1929 April, under the regime of 1*s*. 6*d*. ratio.

Present-Day Characteristics of the Exchange Market.

Throughout this vast continent there is not one important city that can be called the "New York" or "London" of India. The position of either the Clive Street of Calcutta or the wider money market of Bombay cannot be compared with that of the Wall Street in America or that of the Lombard Street in the United Kingdom. Though Bombay has greater share of exchange dealings than either Calcutta or Madras it would be entirely erroneous to minimise the importance of Karachi and Rangoon as important exchange markets.

Compared with the dim early beginning of the exchange markets the first salient characteristic is the close competition that exists in the market. This can be easily discerned by noting "the narrowing" of the exchange points.[14] While

[14] The following quotation from the *Bombay Castle Gazette* explains the exchange operations of the Oriental Bank, the first really strong foreign exchange bank of this country as Benjamin White puts it:

Exchange on London	at six months' sight above	£50 at 1*s*.-10 and 1-4*d*.	per Re.
,, ,,	at three ,, ,,	£20 at 1*s*.-9 and 7-8*d*.	,,
,, ,,	at one ,, ,,	£20 at 1*s*.-9 and 5-8*d*.	,,
,, ,,	at one day's sight above	£5 at 1*s*.-9 and 1-2*d*.	,,

See the notification of the Oriental Bank in the *Bombay Castle Gazette*, Rampart Row, 12th Sept., 1849.

A comparison of the above with modern exchange rate quotations makes this plain. *On Oct. 5th*, 1929, exchange rates in Calcutta were as follows:

T.T.	1*s*.-5$\frac{27}{32}$*d*.
on Demand	1*s*.-5$\frac{27}{32}$*d*.
Banks buying	
three months' sight bills	1*s*.-6$\frac{1}{4}$*d*.
four months' sight bills	1*s*.-6$\frac{3}{8}$*d*.
six months' ,, ,,	1*s*.-6$\frac{19}{32}$*d*.
sight bills	1*s*.-6*d*.
T.T.	1*s*.-5$\frac{15}{16}$*d*.

formerly the difference used to be ranging from $\frac{1}{2}$ to 1*d.* on a rupee the present-day difference is only $\frac{1}{32}d.$ on the average. Difference in exchange might sometimes be as low as $\frac{1}{64}d.$ or even worse as compared with the fair difference of the earlier days.[15] Direct rates between Calcutta and the foreign money centres other than London have also been established under the stress of free competition. But such firm connection as exists with London is not to be met with in the case of the foreign monetary centres.

Nextly, many exchange bills D/A and D/P have arisen under the documentary credit principle. With the growth of the volume of trade the exchange market has become wide as well as steady. Banker's clean bills have also arisen to a certain extent. A clean continuing letter of credit is not generally issued to the Indian importer as yet. So far as the time-length of the bills is considered thirty, sixty and ninety days' bills have come into vogue. Sterling bills are predominant and there are not very many rupee bills even in the matter of our trade with the Eastern countries.[16] The lack of an open discount market precludes the early development of the rupee bills and the absence of the latter has been rendering it difficult to create a short term money market where these can be discounted. This is the vicious circle facing the banking reformers at the present day. The habits of the merchants and the

[15] *See* the Speech of the Chairman of the Chartered Bank of India, annual meeting, March 1928.

[16] Caring solely for profit the Exchange Banks do not allow the import bills to be rediscounted. Though they are drawn for small amounts they can form the nucleus of a discount market in this country. The bulk of the Indian import trade is financed by 60 days' sight D.P. drafts drawn on the Indian importer and the latter has to pay interest usually 6 per cent. from the date of the Bill to the approximate date of the arrival of the proceeds of the bill in London. This rate is raised as soon as the Bank of England rate rises above 5 per cent. If the Exchange Banks were to accept bills instead of purchasing them the benefits of the cheap London discount market could accrue to the importers. But as soon as low interest rates were to continue in the Indian money market the rupee bill can easily become popular. Before the starting of the Central Bank this plan cannot however be realised. *See* C. B. Enquiry Committee Report, pp. 316-318.

industrialists also must change before the bills of exchange can become more abundant. "Manufactured bills" for emergency currency purposes arise in the busy season and practically disappear when the Imperial Bank realises no such necessity.[17] The market for the exchange bills consists practically of the exchange brokers and the exchange banks. There are not a large number of buyers of hundies in the native bazar even, as in the case of the newly created bill market in the Federal Reserve Banking system.[18] The sole burden of financing exports and imports consequently falls on these foreign exchange banks and the London money market in so far as the latter rediscounts the export bills of the Exchange Banks.

Again there is not much of bank acceptance by the Indian Joint-Stock Banks as in the case of the London Acceptance Credit or the Federal Reserve Banking system of America. Unless an extensive use of bank acceptances is forthcoming and an adequate discount market exists there would be no proper co-ordination between the activities of the two kinds of banks, *viz.*, the exchange and the commercial banks. The absence of rupee bills in the import trade is still a marked feature. If the exchange banks need adequate funds for their operations in India there is at present no means of rediscounting or disposing of their import bills in this country. They fall back on the Imperial Bank and secure advances on securities or rediscount their D/A export bills in London and send their resources to finance their Indian business.

The Imperial Bank and the Exchange Banks.

The old historical error that the exchange banks financed foreign trade solely with the help of their own capital resources

[17] *See* A. C. McWatters, Memorandum before the Hilton Young Commission.

[18] *See* W. R. Burgess, the Federal Reserve Banks and the Money Market, Chapter on the Bill Market.

during the years 1860 to 1900 needs no refutation at all.[19] The Imperial Bank of India finances foreign trade only when it helps the exchange banks who might feel reluctant to move funds from London if better money rates were to prevail there or if rapidly fluctuating exchange rates would threaten to involve them in heavy losses if they were to resort to London. If Indian rates are not high enough the same result would happen. The Exchange Banks would secure advances on securities from the Imperial Bank and dependence on the Imperial Bank becomes a marked feature at such times. Thus it indirectly contributes at such times towards the financing of foreign trade. But if the Government were to force the Imperial Bank to raise the bank rate to 8 per cent. as it was done in February, 1929, it might tempt the exchange banks to remove funds to India but much depends on the prospects of the money rates in London and India than anything else. The fluidity of capital depends more on interest rates prevailing at the time than any administrative measures. It would not be far wrong to say that under certain circumstances the Imperial Bank might be forced to finance foreign trade also. It must also be remembered that the Imperial Bank is allowed to conduct foreign exchange business to meet the personal requirements of its customers alone. This amounts on an average to about six crores of rupees.

A Central Bank of Issue and its Control over Exchange.

Now that the long-operating gold exchange standard system has practically removed wide exchange fluctuations altogether, it remains to see how the same desirable feature can be obtained under the Central Bank management of a gold standard. The sole purpose of the gold standard is to achieve

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[19] *See* the Memorial of the Exchange Banks to the Viceroy sent on the 3rd February, 1900, quoted in the Appendix XV, p. 409. Chamberlain Commission, Interim Report, and the Letter of the Government of India sent to the Secretary of State on the 3rd December 1900. *Ibid.*, Appendix XV, p. 407.

stability of foreign exchange. Free gold export shipments and due contraction of credit would restore the exchange rate back to its old moorings. Similarly free gold imports and a liberal credit policy would raise the domestic price-level and check exports with the result that imports would increase and gold would flow back so that the unduly favourable balance of payments would tend to correct itself.[20] This is the conception of the automatic gold standard which however is not the standard that has been adopted of late by the important countries. The new gold standard does not solely aim at creating devices for stabilising exchanges alone but it seeks to stabilise the value of gold and thus prevent long-term upward or downward movements in the value of gold or price levels. An effort is thus being made to attain general stability of the world price-level, over short as well as long-term periods. It is not necessary to discuss the further aspects of the new gold standard which is now being uniformly accepted by almost all other countries.

It is apparent then that if the Reserve Bank were to be started in this country this control over the exchange value of the currency can be secured by its policy. With the disappearance of the Government as the "Currency authority" or its dominance over the Central Bank which we have witnessed in the case of the Imperial Bank, the Central Bank has to maintain the exchange level. Operating the new gold standard whose important features would be the absence of a gold currency and international co-operation with the other new gold standard countries, the procedure of parting with actual gold or gold exchange can be resorted to as in the case of

[20] *See* Taussig, International Trade, Part 3 (1927). An adverse trade balance is set right by altered exchange rates and this would lead to the building up of a favourable trade balance. This corrective would be efficacious if economic conditions do not change, *viz.*, that the volume of domestic currency is not being inflated, that budgets are being balanced, that speculation does not enter the exchange market, that invisible items do not alter the balance of payments and that no arbitrary restrictions are imposed on the movement of trade and of exchange rates.

the Reichsbank of Germany. It might even adopt the obligation to sell gold or gold exchange only when the gold export point is reached as is the case now with the Nederlands Bank to those countries which would permit the free movements of gold. The administrative technique might be different but the principle is always to be the restoring of exchange conditions to stability. Its control over the price-level would be aiming at stability, internal as well as external, *i.e.*, "within as well as without" as Montagu Norman, the Governor of the Bank of England, would put it.[21]

The main problem ahead is not the maintenance of the stable exchange alone, which can however be realised as a part of the Central Bank management of the new gold standard, but our attention should be riveted on the immediate problem of financing foreign trade with domestic resources. Exports and imports have reached the pre-war level only in the year 1927-1928.[22] They are bound to expand in the near future. The financing of this huge foreign trade at home is essential. Another part of the duty would be the facilitating of the transfer of the net balance of payments to India proper.

THE DEFECTS OF THE PRESENT-DAY FOREIGN EXCHANGE BANKS.

The chief counts of indictment against the powerful foreign exchange banks as they exist now are that they compete with the Indian Joint-Stock Banks not only in the matter of securing deposits but in financing borrowers in the slack season, that they drain away resources from this country for services which can be performed equally efficiently by progressive domestic banks, that they promote trade in raw materials and the industrialisation of the country is no definite policy of their own, that they refuse to adapt themselves to the requirements of a great agricultural

[21] *See* the Evidence before the Hilton Young Commission.
[22] *See* the Review of the Trade of India, 1927-28.

country like India where produce advances are more necessary and should be made freely, that they do not teach the principles of foreign investment banking, that they stoop to unfair tactics against budding rivals, that they are tending to amalgamate with the big London Joint-Stock Banks and future economic development might be served well or ill by these huge financial leviathans, that they do not give us an adequate return for the "open-door policy" we maintain, that they form a compact homogeneous group and give no positive encouragement to the Indian Bank officers to rise to positions of responsibility, that they tend to drain away funds from up-country centres to the ports in the busy season thereby leading to better financial facilities to exporters rather than the cultivators and industrialists, that they have not set up economic standards of bank management and organisation before the Indian Joint-Stock Banks who are financing internal trade requirements and that they will not fit in in a nationally managed banking service which may be planned in the near future to develop our national resources and create productive industry.[23] In short, they refuse to be instruments of national progress. In view of their past opposition to the Central Bank proposals, it is likely that, when the Central Bank would be started they would certainly refuse to co-operate with it.[24] Its resolute leadership might be opposed by these banks and Central Bank control might become a mere fantastic dream. Almost a deafening and tumultuous roar of criticism would be levelled against their uncharitable and uninspiring conduct before the Central Banking Committee. No one need be surprised at the particular animus that might be displayed by the critics but the ebullition of national feeling

[23] Another count of indictment is that they do not give satisfactory references to overseas merchants regarding their Indian customers. The Exchange Banks compel the merchant borrowers to insure with foreign Insurance Companies in preference to strong and well-managed Indian ones.

[24] *See* the Evidence of C. Nicoll before Hilton Young Commission, 9N-14148, Vol. V.

is such that many unjust accusations would be levelled and little foibles would be magnified into serious mistakes.

The above formidable list of their shortcomings and defects does not mean that they are not of any use to this country. As models of sound finance the Indian banking institutions can of course learn something from them. The Indian depositors would also have to be grateful to them and every failure of an Indian Bank has indirectly added to their prestige and deposit-attracting capacity. Their skill, freedom from dishonest manipulation of bank funds for Director's pet schemes and the maintenance of liquidity of their resources are indeed objects which ought to be the subject of proper emulation on the part of the Indian Joint-Stock Banks. These have contributed much to raise the level of their steady profits which the Exchange Banks declare at present.

In view of the fact that the World Economic Conference[25] has passed resolutions to the effect that "no discriminatory legislation" against foreigners should be passed and in view of the powerful influence the exchange bankers wield in the London financial circles it would be impossible to enact any punitive or provocative taxation measures against them so long as they confine their activities to international commerce alone. Similar well-drafted laws which can be applied to our domestic banks can be imposed on them. A slight return for the trading privileges can be secured. The systematic training of Indian apprentices in the art of banking can be secured out of these refractory exchange banks. But if any further penal measures are to be thought of, such as increased taxation or the withdrawing of the right to attract deposits or the right to open branches in the interior of the country they can easily evade them by registering themselves with Rupee capital as local

[25] *See* the Report of the World Economic Conference, published by the League of Nations, Vol. II, p. 42.

See also the Proceedings of the International Conference on the Treatment of Foreigners, held in Paris in 1929.

banks. Such has been the case in Spain.[26] As the Indian field is wide enough to permit the successful working of a number of banking institutions they would not lose this opportunity to defeat the real intentions of any penal legislation that can be enacted. But as I have stated elsewhere if these local banks are forced to maintain an up-to-date register of shareholders[27] there would be no possibility to escape this legislation. For the purposes of this act it can be enacted that all banking companies whose shareholders' list has more than two-thirds of its members from outside the country should be considered as foreign banking companies.

Without a real change of heart it would be difficult to make them realise our requirements. Our appeal to them to act as indispensable adjuncts to a nation-wide banking system would be vain. The real remedy then is to proceed cautiously and though our policy should be based on the justifiable motive of destroying all vested interests, the retention of these banks as useful complements in our banking organisation is the only wise alternative that is left to us. In the beginning, we will have to supplement their services and it is only after a time that we can hope to counteract their influence. Our local exchange Banks must be helped by the Central Bank to realise this aspiration. As in Japan, we should retain them in the banking system as willing helpmates, useful brethren, and subsidiary instruments. They must become a cog in the banking wheel. Their present-day uncontrollable and unassimilable part in the banking system and their acting as the chief controllers of our economic progress must be remedied.

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[26] *See* the Chairman's Speech, Westminster Bank's Annual Meeting, 1923; *See* Sykes, The Present Position of English Joint-Stock Banking, p. 28.

[27] The newly enacted Company Law of 1929 of the United Kingdom contains this provision. A penalty is also imposed if the index to the register of the shareholders is not kept up to date. *See* sections mentioned in Part IV of the New Companies Act of 1929.

THE FINANCING OF OUR FOREIGN TRADE WITH DOMESTIC RESOURCES.

It has already been pointed out how under certain circumstances the Imperial Bank's funds might be utilised by the Exchange banks to finance our export trade. The lack of co-ordination between internal and foreign trade financing breaks down under these circumstances. If the Central Bank or the Reserve Bank were to lend its exchange funds at low rates of interest after taking proper security from the domestic exchange banks the financing of foreign trade with home funds can be accomplished. Under certain circumstances such as abnormal exports these resources might be reduced or tightened. But a Syndicate of bankers can then be formed to ease the situation, if the Bank of England refuses to help the Central Bank by rediscounting its bill assets in London. A Syndicate of bankers specially formed for the purpose can be utilised in financing the export bills. It might so happen that the local exchange banks might become saddled with huge London credits arising out of the purchase of export bills, *i.e.*, too many London credits than are necessary might be created. The Central Bank can however, purchase these exchange funds by issuing an equal amount of notes at home, if such an abnormally one-sided export trade were to lead to the piling up of exchange funds abroad. This is how general trade prosperity fluctuations can be financed by the help of the Central Bank's resources.

In the case of general trade adversity fluctuations when India has to pay the foreign countries the Central Bank can mobilise the foreign investments held by the Indian people. These can be sold abroad while it pays the Indian owners of the same in rupees. It can float temporary loans abroad to have exchange funds for the purpose of meeting drafts on the same at the gold export point from this country. The undue slump of the exchange can be rectified by this method if especially the price movement tends to be relatively stable

or constant. There would be no very great alterations from the purchasing power parity unless the exchange dealers lose all confidence in the early revival of trade. As these tend to watch the draining away of the exchange funds kept abroad by the Central Bank their gloom tends to increase. These speculative fluctuations might complicate the situation and retard the process of recovery, but their bias would soon become corrected if trade follows the normal course and gives rise to the net balance of payments as in normal years.

The seasonal exchange fluctuations due to seasonal variations confine themselves to the range of a few points. The Central Bank can easily continue the pegging of exchange between the specie points by selling gold or foreign exchange at the gold export point and check the rise in exchange above the gold import point by mobilising gold or gold exchange in its vaults and introducing notes against the same at the gold import point. Mere gold movements would correct the situation. The Ricardian theory of outflow and inflow of gold would preserve the exchange level intact within the gold specie points. A programme of comparative stabilisation of internal prices by the Central Bank would tend to stabilise exchanges at the same time and the dual objective of relatively stable prices and tolerably stable exchanges can be secured without any great friction either to business or banking under an intelligent control and management of the new gold standard.

All this presupposes the existence of the Indian Exchange Banks and a Central Bank willing to help them so as to finance India's foreign trade at home with domestic resources. Since the dismal experience of the Tata Industrial Bank it is becoming practically impossible to create strong Indian Joint-Stock Banks for conducting foreign exchange business alone. Proposals have been made that an Indian Exchange Bank would have to be started or the present Imperial Bank can be converted into an Indian Exchange Bank. Considering the

impossibility of raising large capital for banking business at least on this side of India, it would be far better to create an Indian Overseas Bank which would have a part of its capital raised out of the subscriptions of the individual capitalists and the remainder contributed by the present Indian Joint-Stock Banks. It would easily be possible to raise a large amount of capital according to this method for conducting exchange business at a remunerative scale. If the Indian exporters command better prices for their export bills at the hands of the Indian Overseas Bank the business of financing export trade would easily be attracted by it. The Indian Overseas Bank should maintain always in its initial stages rates about one or two points more favourable than those of the foreign exchange banks in this country. If the exporters secure greater resources by selling their export bills to the Indian Overseas Bank than it would be the case when they sell them to the foreign exchange banks they would flock to the standard of the new bank. If the Central Bank were to help it with funds for this purpose at a low rate of interest more export bills can be financed by the Indian Overseas Bank. More rupees should be granted by the Indian Overseas Bank when purchasing the export bills at differential rates. Of course, rate-cutting would ensue and for quite a long period the foreign exchange banks would prove to be effective competitors. Similar should be the treatment shown towards the importers. They should be securing greater return in foreign currency by flocking to the standard of the Indian Overseas Bank than when they resort to the foreign exchange bank. It is only by this way that we can hope to create an institution meant for conducting foreign exchange business with domestic resources. This is the only way of defeating the present monopolistic character of the foreign exchange banks over the exchange situation. This does not mean that the rupee-sterling exchange would not rule the day in the near future. All foreign exchange rates would be resting on the

rupee-sterling rate for, as in the case of most other countries, we pay our indebtedness in London. We hold foreign balances in London and any exchange rate would be depending on the rate of exchange on London and adjusted by a current rate of other country—London Exchange.

Its Advantages.

It remains to point out the main advantages of financing our trade entirely with the help of our domestic resources. An unnecessary tribute is being paid to the London Bankers who accept our bills and discount them in the London Money Market. Payment in sterling would be avoided and exchange risks need not be thought of. Though the Gold Exchange standard gives some amount of protection against fluctuations the resulting inconvenience to the Indian exporters in receiving a sterling bill and selling them to Indian Exchange Banks to receive rupees for them can be avoided. The Indian Importer likewise suffers in having to pay a sterling bill drawn against him. Dealings in future can eliminate all exchange risks.

The privacy of a discount market and the keeping of trade information would be achieved under this system.[28] The newly arising national pride resents the financing of our trade solely by means of sterling bills.

Free opportunity for a safe and sound employment of short-term liquid resources would be found in the discount market. The unwholesome over-investment of funds by the present-day Indian Joint-Stock Banks in gilt-edged securities can be checked. The immobilising of the bank funds arising out of excessive investment is a grave evil to the existing Indian Joint-Stock Banks for it leads to an unwholesome concentration of funds in one direction which is bad finance.

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[28] It is on this ground that the United States of America began to encourage the development of bank acceptances and finance its foreign trade with the help of its own resources.

The discounting of internal and external bills drawn in the course of trading would diminish the opportunities in the above direction of over-investment in Government securities.

Nextly, the Central Reserve Bank would be powerless and ineffective to control credit if the discount market does not exist. Under the new banking conditions that would exist if a Central Reserve Bank were to be created, this active participation of the Central Banker would have a beneficial influence on the market. To guide and control the other banks and to regulate interest rates and money conditions the Central Bank must have liquid resources to efficiently discharge its public trust of checking undue credit expansion and easing credit when it is unwisely restricted. The smooth and gradual control over the discount and the money market is possible only if the Central Bank can have these bills marshalled in a steady succession of maturities. As a recent writer says[29] bills discounted and bought in the open market offer an ideal current of maturities. Certificates of Government indebtedness are a poor second. Government bonds and treasury notes have no liquidity at all on the basis of early and successive maturities. Their value as instruments of credit control must depend entirely on their ready saleability, a quality which they fortunately have to a high degree. It might indeed be true that the Federal Reserve Banks conduct open market operations with the help of Government securities rather than banker's bills. As the open market operations are undoubtedly beneficial to a certain extent these would have to be pursued by any Central Bank and an organised money market would be essential for the success of its measures. It is admitted even by Mr. J. S. Lawrence that "these open market operations would be very helpful at the time of gold movements, quarter-day adjustments, the attraction and discouragement of international commercial financing and the removal of undesirable items from the bank balance sheets." The larger

[29] J. S. Lawrence, "The Stabilisation of Prices," p. 2ɔ4.

ideals of price control and business stabilisation may not be achieved by this "delicate touch" or lever of the Central Bank. Considering the manifold advantages that would arise by the creation of a discount market and the financing of our foreign trade with the help of domestic funds and realising that both Japan and America have organised similar attempts to remove their dependence on London, our objective should be in this direction. It is indeed true that in both these cases the attempts are not very successful as yet. But they point out unmistakably which way the banking progress lies. A sustained endeavour has to be made by the Indian bankers in this direction. Nothing is so important in the whole field of banking reconstruction as this.

One fundamental feature of this banking reconstruction should aim at diverting the surplus home or domestic funds for the financing of foreign trade and *vice versa, i.e.*, surplus foreign funds for financing home trade and industries. The more extensive use of bank acceptances[30] and an adequate discount market would facilitate the financing of foreign trade. In financing imports rupee bills ought to be developed. Specialised discount houses ought to conduct this operation. It is foreign interest-bearing bills that predominate in the import trade. No foreign exchange bank furnishes us with a report on this situation and most of the bills are drawn in sterling and are kept till maturity in this country and are not rediscounted in this country.

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[30] Bill acceptance and discount market can hardly be created so long as business is run on old ways of cash credit; so long as no business organisations exist for gauging credit and the credit standing of the firms; so long as specialising acceptance houses are not in existence as in London; and so long as the Indian Joint-Stock Banks are very conservative and refuse to educate people in the use of bills. These can be remedied only by more education for bankers and businessmen concerning the advantages and disadvantages of bills of exchange and carefully enacted regulations regarding the use of such instrumens. The Central Bank itself should buy and sell such bills of exchange in the open market just to popularise these bills as short-term investments.

OTHER ANCILLARY MEASURES.

Nextly, the initiation of a programme which involves thorough-going co-operation between the Central Bank of this country and the Bank of England would be essential. Otherwise the Anglo-Indian Exchange Banks will refuse to obey the penal rates of rediscounting imposed by the Central Bank and resort to the Bank of England or the London Money Market. An independent monetary policy on the part of the Central Bank would never be effective if the powerful foreign exchange banks with their rich shareholders, intelligent direction and financial support from London wish to run counter to the course of action proposed by the Central Bank of Issue of this country.

Finally, the Central Bank of the country should be intelligent enough to understand the drift of monetary conditions in London. If high money rates were to prevail in London the use of the exchange funds on the call market would enable the Central Bank to secure greater return than before and consequently induce it to lower the Indian rates. The Indian Exchange Banks would do it, if the Central Bank does not pursue this method. Thus it has to co-operate with the London money market and the Bank of England. Their mutual policies should not normally create disturbing influences in the different centres. The question of securing adequate funds can be solved easily by allowing the Central Bank of this country to secure access to the London Money Market and rediscount its bills at the Bank of England. It would also facilitate the stabilising of the money market in this country and with lower rates prevailing in this country Indian funds can even be removed to London. That this can be accomplished in due course of time need not be[31] doubted.

[31] This was the idea of the late Sir Edward Holden when he advocated a Central Bank for India. *See* his speech at the Annual General Meeting of the London City and Midland Bank, the 24th January, 1913.

Our Plan Ahead.

Although the chief meritorious characteristic of present-day financing of foreign trade lies in our possessing specialising exchange banks which do not usually tie up their resources in long-term investments in industries or agriculture still the main improvement needed is the financing of foreign trade with domestic resources. It should be done by funds raised inside the country. The would-be Central Bank can accomplish much in this direction. Besides securing exchange stability within the specie points its endeavour should be in the direction of helping the Indian Overseas Bank which would have to be created with the co-operative action on the part of the public and the present Indian Joint-Stock Banks. Acting as the central co-ordinator of banking funds it can take up an active part in controlling credit not only by lowering or raising discount rates but by buying and selling exchange bills at the time the exchange rates deviate from the normal points. Financial co-operation between all these agencies would easily enable us to finance our foreign trade. The use of bank acceptances and the development of a discount market have already been pointed out as the other necessary measures to popularise the rupee bills and they can be drawn in our import trade. The use of bills in place of cash credits in the matter of financing the merchant's requirements ought to take place. Regular specialising discount houses would ease the situation greatly. They can buy bills at banks and act as intermediaries between exchange dealers and bankers and between merchants and bankers. If the Indian Joint-Stock Banks give up other entanglements and specialise in foreign exchange business they can easily succeed if they conduct sound exchange banking.

Conclusion.

A comparative price-steadying programme, a proper external borrowing policy on the part of the Government,

individuals and *quasi*-public bodies, a carefully framed note-issuing privilege and the extension of loans by the Reserve Bank on commercial paper or bills or notes instead of Government bonds and shares thus restricting the scope for stock exchange speculation, are some of the most important measures which our Central Bank would have to bear in mind. These ancillary reforms are essential if the vital question of financing foreign trade with domestic funds can succeed. With the prosperity of her great exporting industries such as cotton, jute, tea, hides and skins, increasing efficiency of labour, a mercantile marine of her own, which reduces the invisible payments under this heading and the prosperity of Indian people emigrating abroad which would tend to an increase of remittances into the country, the net balance of payments would always be in her favour and this fundamental factor would greatly facilitate the task which the Central Bank would have to take up in right earnest. Facilitating free gold movements in normal times and making provision for meeting extraordinary situations as slumps and general trade prosperity fluctuations, the exchange situation can always be controlled by the Central Bank. Under an enlightened and consciously controlled Central Bank, which carefully manages its foreign portfolio, the present-day Government arrangements for gold exchange funds would disappear. The successful management of the new gold standard by the Central Bank would tackle the situation and eliminate all exchange fluctuations which are very demoralising either to business or finance. The resumption of the new gold standard without exchange-pegging devices will limit the possibilities of exchange speculation at any time. Its liberal help to the Indian Overseas Bank or the Indian Exchange Banks alone can hope to do something in this direction of financing foreign trade with domestic funds. The present-day tendency of maintaining an *Imperium in imperio* would be checked and the Foreign Exchange Banks recognising the different or

changed political situation might resort to the tactful method of offering a portion of their increased capital for subscription in this country so as to placate public opinion, but the stigma attached to the "foreign banks" would always remain and the local people would securely support and favour the local banks. Thus the attempt of the foreign exchange banks would become futile if an intelligent and persistent effort is made by the local banks to finance foreign trade. Entrenched strongly in the favour of the local people those local banks can with the minimum of legislative interference undermine the position of the foreign and Anglo-Indian Exchange Banks. This is the only rational way of providing an effective solution for a potentially inconvenient banking monopoly. The formulation of such a well-conceived plan would be far more advisable than the enacting of futile and mischievous programmes to limit the services of the present-day foreign exchange banks of this country in the direction of financing our growing foreign trade. The cry that the present number of foreign exchange banks is already in excess of legitimate requirements will of course be raised but it ought not to be allowed to side-track our efforts in solving the main problem of this country. Political independence without financial independence is a misnomer and a will-o'-the wisp. It is like grasping the shadow instead of the real substance.

APPENDIX VIII

THE FUTURE OF THE IMPERIAL BANK OF INDIA*

Unable to appreciably lower the bank rate or stabilize it all throughout the year at a more equitable level than at present, and subject to the dictation of the financial advisors of the Government and deprived of the privilege of note-issue, the Imperial Bank of India has failed to develop into "a real national institution."

In spite of its humble services which should on no account be belittled or ignored,† it has not given satisfaction to anybody except perhaps its shareholders. The general public feel sorely disappointed at the slow progress of the Indianization scheme of its officers and apprentices. The Indian Joint-Stock Banks have no love lost for this "State-aided competitor." The Exchange Banks are apprehensive that their exchange monopoly would be jeopardized by making the Imperial Bank of India an ordinary Joint-Stock Bank and granting it full freedom to conduct any business which its shareholders would determine as soon as it sheds its semi-Central Banking character. It would excite the envy and dissatisfaction of the existing banks whose business would have to be encroached upon to maintain its present high rate of dividend, *viz.*, 16 per cent. They would surely consider it as a millstone tied round their neck.

As it is, it is a commercial bank with about 200 branches extending far and wide over the whole country. As a commercial bank it has come into open competition with the other kinds of banks transacting business in the interior. Its anxiety to extend banking facilities has forced it to spread a

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* This was first published in the *Mysore Economic Journal*, Sept., 1930.

† *See* my *Present Day Banking in India*, Third Edition, Chapter on 'The Imperial Bank of India.'

network of commercial branches and they are slowly building up business connections at these different centres.

Now that the idea of its being developed into a Central Bank has been disapproved by the Hilton Young Commission itself, a new Central Bank would have to be created. With the formation of a new Central Bank all irksome restrictions on the character of its business would be removed. Perhaps it would be one among the different banks selected to act as a Government Depository. With a London Office free to conduct commercial banking, exchange business would naturally be thought of. The technique of exchange banking is not difficult for it to master and as it has best experts in its hands and branches all over the country, it would prove the most formidable competitor to the existing Exchange Banks. But exchange business is being already satisfactorily discharged by about 18 banks who are finding it difficult to maintain their existing rate of dividend as a result of excessive competition amongst themselves. The advent of the Imperial Bank into the ring would make matters worse. Nobody knows the exact strength of the Indian shareholders of the Imperial Bank.‡ Granted that it is about 45 per cent., it clearly follows that the Imperial Bank would soon join the ranks of the Exchange Banks. When it attracts London deposits, as do the present Exchange Banks, it would be London money that would be financing our foreign trade. The main problem of conducting the financing of foreign trade with domestic funds would be defeated. It can easily fraternise with the existing Exchange Banks. By becoming a member of the Exchange Banks Association it would doubtless follow the same policy as that of the rest of the Exchange Banks. At present there is a lot of dissatisfaction at the treatment meted out to the Indian customers by the foreign Exchange Banks. As a member of the same Association it

‡ *See* Evidence of Managing Governor, Imperial Bank, before the C. B. Enquiry Committee

would undoubtedly continue the best traditions of these Exchange Banks.

It must be remembered that as soon as the Central Bank is started with branches at the regional centres such as Cawnpore, Lahore, Rangoon, Bombay, Calcutta and Madras, the bulk of the Government interest-free deposit money would be withdrawn. The clearing accounts of the other banks would also be withdrawn if the Reserve Bank undertakes to act as a Settling Bank for clearing purposes. Becoming an ordinary bank it would have to pay current accounts at the rates which the other competing banks are paying. The maintenance of branches and the necessity to pay the depositors point out that its success would depend on a *constant and steady turnover of its capital resources.* So the suggestion that it should be converted into a big Industrial Bank, for it has expert management at its back, business connections with industries and a regional character to enable it to initiate the policy of the financing of industries, is not based on sound reasoning.§ Non-terminable loans and continuous locking up of capital for a lengthy period would reduce its turnover of capital and it would be unable to maintain the existing rate of dividend to the shareholders. It would require a lot of inequitable sacrifices on the part of the shareholders. After all it is not the mere lack of financial resources and facilities that is standing in the way of the industrial progress of this country.

With a long record of honourable service the Imperial Bank ought to excel all other banks in its deposit business, security dealings and trade credits and be behind the Exchange Banks in respect of its vigour in pursuit of the foreign exchange business. For the unique distinction of being a bank for industry, par excellence, to which all other branches of activity are to be subordinated, the Imperial Bank cannot hope to aspire on account of its excessive capital and present-day high dividends.

§ *See* the Banking number of the *Indian Finance*, January 8, 1930.

Acting as the chief provider of short-term capital for the co-operative banks, and holding the debentures that would be floated by the provincial land mortgage banks as part of its investments, it can easily afford to continue its present commercial character which does not however preclude it either from financing the existing industries in which it might have confidence or conducting exchange business to satisfy all the requirements of its existing customers. But it must bear in mind that it should not be saddled with heavy external deposits attracted in London. The collection of these heavy external deposits for use in this country might cement the financial ties between London and this country, but this policy needs very judicious handling on the part of the Imperial Bank. London deposits might be lying in its hands for a long time but these must be covered sufficiently by quick London assets. Heavy Indian assets would not help the London branch in case of a drain on the London branch. So if it were to develop into an Industrial Bank its London branch would be a costly luxury. Long-term capital can indeed be tapped by floating debentures and if these are to be floated for 10 to 20 times its present capital the demand for industrial capital would not arise to such an extent as to absorb a part of the industrial capital supply created by the Imperial Bank.

Thus the future business of the Imperial Bank may be extraordinarily wide or restricted. It depends on its own choice. It can carry on banking business, acquire deposits, make advances, discount bills, issue drafts, deal in exchanges, specie and precious metals. It would be empowered to borrow money and do anything incidental to any of its powers and it would continue the policy of opening new branches as in the past. It may compete more vigorously than at present with the existing Banks. If it were to continue holding Government deposits, though to a limited extent than at present, it has to maintain a very liquid position and this alone will enable it to maintain the financial prestige which it has built up out of a long and honourable record of service.

It is quite fit to conduct exchange banking or industrial banking involving a large turnover of funds into lock-up advances. But the exigencies of the situation demand its continuance as a true commercial bank—as a bank of deposit, discount and exchange. Its savings Bank Department should continue. It can likewise maintain a separate Industrial Credit department where long-term loans can be given to co-operative banks, industries and other banks. Any additional money needed for this business can be secured by floating debentures. This must be definitely understood as non-commercial business and not allowed to directly clash with its commercial business. Thus envisaged its future seems to be of a big commercial bank combining within itself miscellaneous functions of all sorts which would be kept entirely apart from the pure functions of a commercial bank and should on no score be allowed to distract the responsible administration of the Imperial Bank. Enough has been stated to stress the points that it would be dangerous and suicidal to convert the present Imperial Bank of India into an effective Industrial Bank or a sole Exchange Bank operating on a competitive basis with the existing exchange banking institutions.

Considering the fact that the most crying need of India is the extension of modern banking facilities to the interior, the Imperial Bank should continue this useful service in the near future.* Whether subsidised to the amount recommended by the Hilton-Young Commission or not, it should continue to act as a commercial bank and be the acknowledged head of the commercial banks standing ever ready to tap the central reservoir of credit by rediscounting agricultural, industrial and commercial paper and passing on these funds to the co-operative societies which would be financing the agricultural industries, the cottage industries and other existing industries so far as their current financial requirements might be concerned.

* There is no advantage gained by allowing it to continue as a "hybrid institution trying painfully to combine incompatible functions" as Sir Basil Blackett describes it. *See* his address before Delhi University, 1926.